CITY OF HARRISONBURG, VIRGINIA

FINANCIAL TREND MONITORING SYSTEM

AN EVALUATION OF THE CITY'S FINANCIAL CONDITION

For the Five Year Period Ended June 30, 2009

17th Edition

FINANCIAL TREND MONITORING SYSTEM
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Introduction

One of City Council's eleven 1993 cost containment goals was to "review the past five years for benchmarking and evaluating key trends in financial planning for the City and management." To address that goal staff looked at a number of ways in which to develop the benchmarking and evaluation of key trends. A decision was made to use a format developed in 1980 that was revised in 1986 and again in 2003 by the International City/County Management Association (ICMA). The format calls for the development of a Financial Trend Monitoring System (FTMS) based on a number of primary factors that influence a local government's financial condition. A number of quantifiable indicators were then developed that were used to measure different aspects of the factors. The indicators were also used to monitor changes in order to identify trends. The development of this system allowed the City to do the following:

1. Develop quantifiable indicators that will:
    a. Provide a better understanding of the City's financial condition.
    b. Identify emerging problems before they reach serious proportions.
    c. Identify existing problems that may not be readily apparent.
    d. Present a straightforward picture of the City's financial strengths and weaknesses.
    e. Introduce long range considerations into the annual budget process.
    f. Assist in establishing future financial policies.
2. Incorporate benchmarks that are used by national credit rating agencies.
3. Combine financial and nonfinancial data in the same analysis.

The initial development of this system in 1994 was under the general direction of Lester O. Seal, Director of Finance. However, credit for much of the initial work (factors one through seven) must go to Thomas F. McKenzie, Peter A. Poirot and Neil D. Showalter, who were MBA students at James Madison University. Early into the project, Dr. Carl Weaver, who was head of the MBA program at

JMU at that time, was contacted about having some of his students assist with the project. Dr. Weaver selected these three students and they did an outstanding job at no cost to the City. Factors eight through twelve were developed primarily by the City Manager and staff based on the ICMA model.

The ICMA's handbook, *Evaluating Financial Condition*, served as the primary source document for the indicators and the implications associated with each indicator. The 2003 edition of ICMA's handbook uses 42 quantifiable indicators to identify trends that may be occurring within local governments and classifies "warning" trends for the indicators. The City's FTMS develops 26 of those indicators and compares what is happening in Harrisonburg with the warning trends identified by the ICMA handbook, and when possible, explains any unusual trends observed. It is important to recognize that the trends identified are simply numerical indicators. Numbers ignore political constraints, the personal preferences of City leaders, and the wishes of Harrisonburg residents. Clearly, the numbers are only part of the overall picture.

Factor 1
Revenue Indicators

It is important to study and analyze revenues because, without revenues, a government cannot provide services. In addition to analyzing total revenues, there are a number of things to consider. The City does not want to be overly dependent on any one source of revenue whether it is from property owners, businesses, or external sources (for example the federal government). If there are too many conditions attached to its revenues, the City may not have the flexibility to adjust to changing demands. If revenue growth rates do not match expenditure growth rates and population growth rates, the City may experience large operating deficits in the future or it may have to cut back on services or raise taxes, neither of which is politically popular.

Analyzing revenues will help to identify the following problems:

- Deterioration of the revenue base
- Over dependence on external sources of funding
- Poor estimating and forecasting techniques
- An unfair tax burden on one segment of the population, i.e., property owners
- Poor collection procedures

Indicator 5, One -Time Revenues, was not developed.

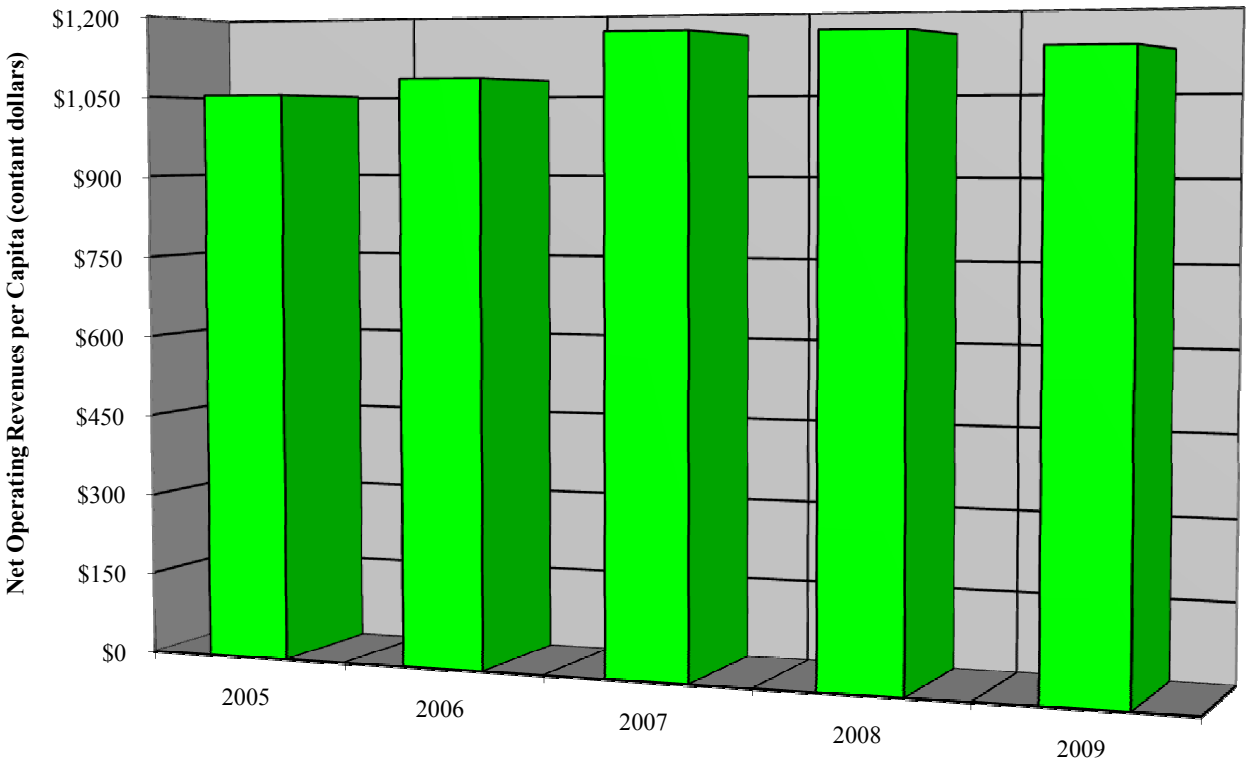
Indicator 1
Net Operating Revenues per Capita

Net operating revenues per capita show changes in revenues relative to changes in population. Revenue growth areas over the past five years include real estate taxes, personal property taxes, and School Board intergovernmental revenue. Increasing real estate assessments and increased personal property tax rates have been contributing factors to growth in these areas. However, due to deteriorating economic conditions that began in fiscal year 2008, economically sensitive revenues such as sales taxes, restaurant food taxes and hotel/motel taxes have either remained flat or actually decreased since 2007. Although net operating revenues per capita in constant dollars have increased overall 7.4% over the past five years, the City has been experiencing a decreasing trend for this indicator since 2007. A declining trend indicates that inflation has outpaced net operating revenues growth. The nominal dollar five-year growth rate is 21%.

The important issue to consider is the reason(s) for revenue growth. Are total tax revenues rising because of higher tax rates, more population growth, or inflation? This factor needs to be closely monitored. What happens when population growth no longer results in an increase in revenues? What if more public assistance households move into the City or if more are created by unemployment? Is it reasonable to assume that the increased level of revenues will continue? Do increased revenues per capita indicate an increase in the tax burden? What would be the effect on the City if businesses and citizens decided to relocate to jurisdictions that have lower tax burdens?

Description	2005	2006	2007	2008	2009
Net Operating Revenues (Nominal)	$84,859,232	$92,132,547	$102,684,767	$108,435,524	$110,186,518
CPI for the Area (1982-84=1.000)	1.846	1.922	1.971	2.050	2.080
Net Operating Revenues (Constant)	$45,969,248	$47,935,768	$52,097,802	$52,895,378	$52,974,288
Population	43,694	44,340	44,852	45,616	46,896
Net Operating Revenues per Capita (Nominal)	$1,942	$2,078	$2,289	$2,377	$2,350
Net Operating Revenues per Capita (Constant)	$1,052	$1,081	$1,162	$1,160	$1,130

Net Operating Revenues per Capita



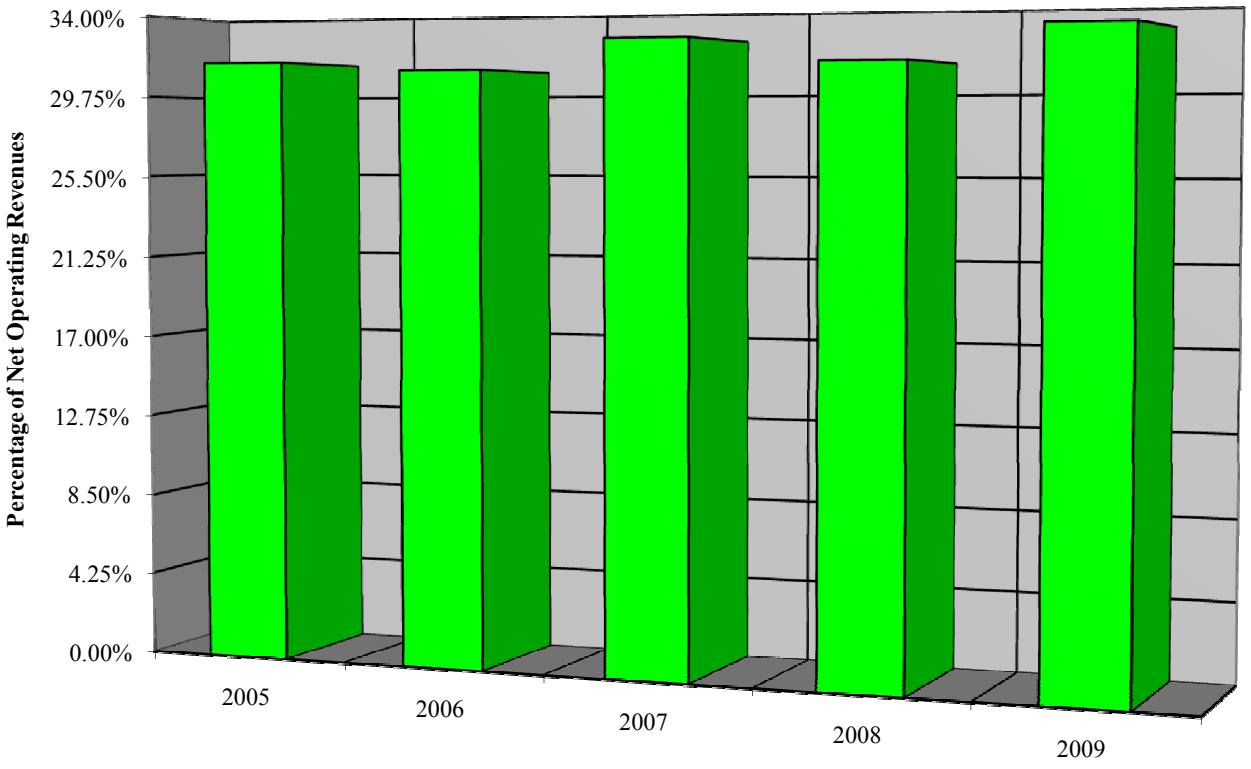
Indicator 2
Restricted Revenues

Restricted revenues are those revenues that are earmarked for specific uses. Categorical aid for education is one example. While these revenues are restricted, the programs they support should not be looked upon as optional programs that can be easily cut. If these sources of revenue dry up, the City may have to make the tough decision of cutting a vital program or paying for the program from other revenue sources. As the percentage of restricted revenues increases, a city loses its flexibility. As the needs and desires of constituents change, the City finds itself increasingly unable to meet those changing needs because of revenue restrictions.

Restricted revenues as a percentage of total operating revenues have been trending upward since 2005. Since 2005, state funding for education has increased $7.6 million (45.8%) with the largest portion of the increase occurring in 2007 and 2009, while federal funding for education has increased $739,453 (17.3%) over the same time period. The Handbook suggests that a locality should analyze how essential these services are to the locality and its citizens, and develop contingency plans for funding those services deemed essential. Since the majority of these revenues are used for education, the City has very little choice other than to fund these programs.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Restricted Revenues	$26,728,564	$28,611,103	$33,454,440	$34,030,412	$36,491,905
Net Operating Revenues	$84,859,232	$92,132,547	$102,684,767	$108,435,524	$110,186,518
Restricted Revenues as a Percentage of Net Operating Revenues	31.50%	31.05%	32.58%	31.38%	33.12%

Restricted Revenues



Indicator 3
Intergovernmental Revenues

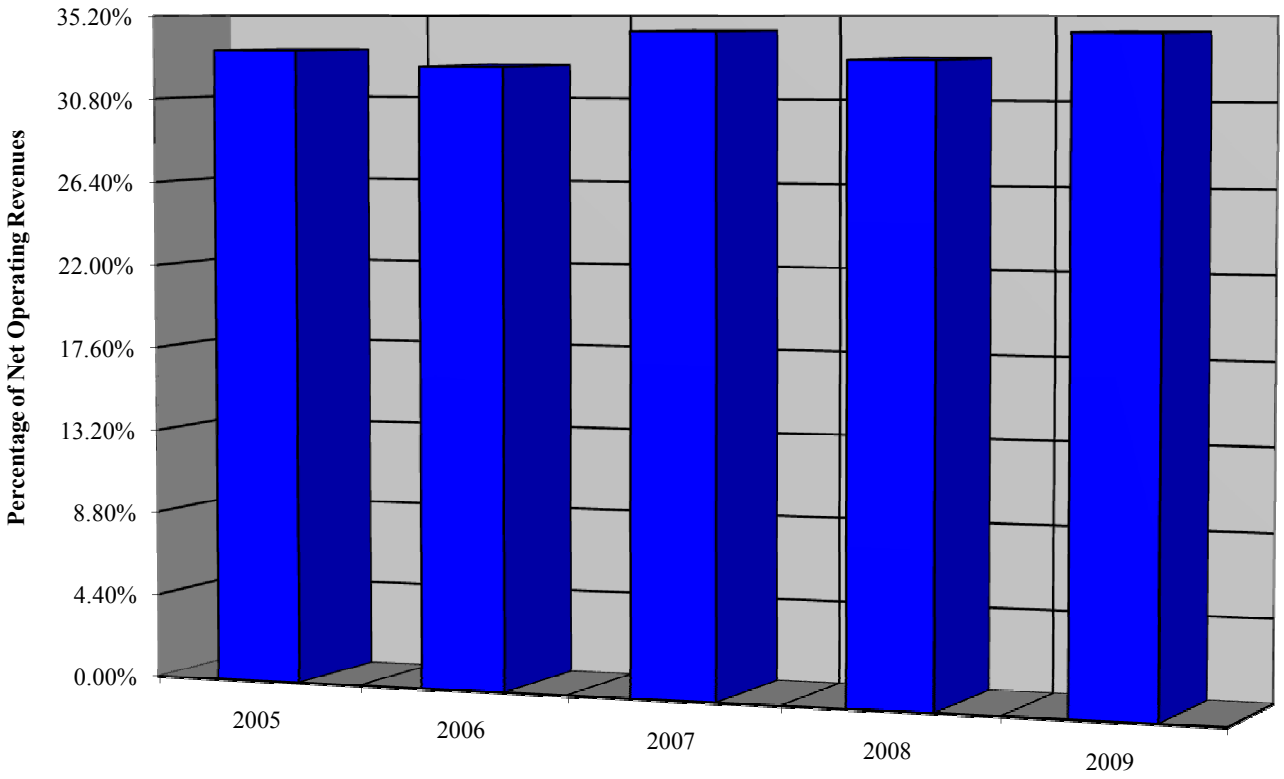
Analyzing intergovernmental revenues as a percentage of total operating revenues is important because, while intergovernmental revenues will always be a major component of total revenues, localities do not want to rely too heavily on external support for several reasons. First, those revenues can be reduced or eliminated, often without input from the locality. Second, there are often conditions attached to intergovernmental revenues.

Intergovernmental revenues as a percentage of total revenues have increased slightly since 2005. The overall trend of increasing intergovernmental revenues is mainly due to the Commonwealth's basic school aid funding for education, which has increased $4.3 million (52.8%) and total federal funding for education, which has increased $739,453 (17.4%) over the past five years. Total intergovernmental funding for education has increased $8.4 million (39.6%) since 2005. Other contributing factors to the increasing trend includes the Commonwealth's funding for the School Board's fringe benefits and standard of quality funding, as well as, street and highway maintenance funding.

The City should keep in mind the following issues. Are the trends we have identified likely to continue? What contingency plans exist in case these revenues are cut or are less than anticipated? If intergovernmental revenues diminish, can the programs that the funds support be terminated or will a new revenue source need to be found?

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Intergovernmental Revenues	$28,335,359	$30,030,900	$35,396,628	$35,813,771	$37,961,720
Net Operating Revenues	$84,859,232	$92,132,547	$102,684,767	$108,435,524	$110,186,518
Intergovernmental Revenues as a Percentage of Net Operating Revenues	33.39%	32.60%	34.47%	33.03%	34.45%

Intergovernmental Revenues



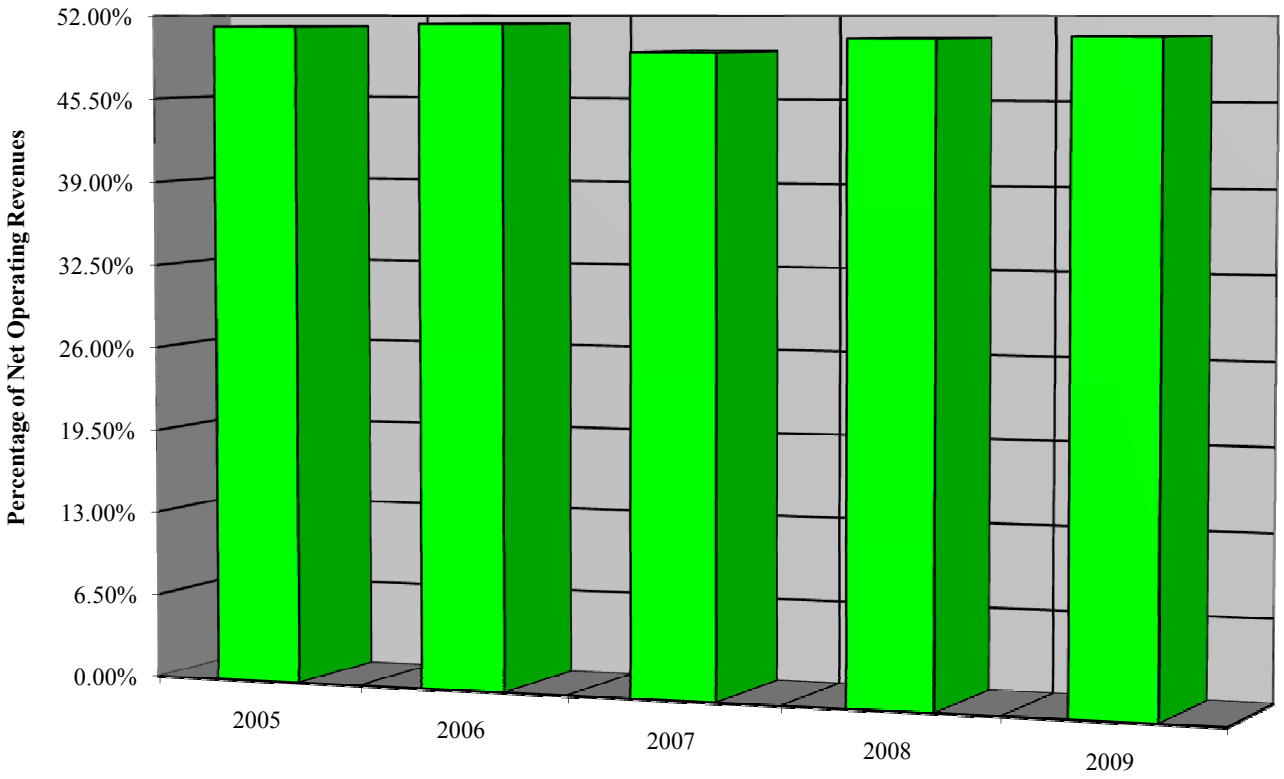
Indicator 4
Elastic Revenues

Elastic revenues are revenues that respond directly to changes in the economy. In general, during inflationary periods it is desirable to have a high percentage of elastic tax revenues in order to keep pace with the rising prices a government must incur. Elastic tax revenues for purposes of this indicator are all property taxes, local sales taxes, business license taxes, hotel/motel room taxes, restaurant food taxes and admission taxes.

This indicator has declined slightly overall since 2005 but has been generally trending upwards since 2007. This indicator tends to have an inverse relationship to the intergovernmental revenues indicator. Due to an increase in real estate assessments in 2008 and the first annual reassessment in 2009, real estate tax collections have increased $8.1 million (66.6%) since 2005. An increase in the personal property tax rate in 2007 did increase elastic revenues by $1.4 million compared to 2006, but this increase was offset by the change in personal property tax reimbursements from the state. The state capped locality reimbursements which had the effect of making this revenue intergovernmental versus elastic. Restaurant food tax collections have increased $1.3 million (19.8%) since 2005 while sales tax collections have increased only $313,000 (2.9%) over the past five years.

Description	2005	2006	2007	2008	2009
Elastic Revenues	$43,435,502	$47,362,132	$50,615,194	$54,607,655	$55,696,474
Net Operating Revenues	$84,859,232	$92,132,547	$102,684,767	$108,435,524	$110,186,518
Elastic Revenues as a Percentage of Net Operating Revenues	51.19%	51.41%	49.29%	50.36%	50.55%

Elastic Revenues



Indicator 6
Major Tax Revenues

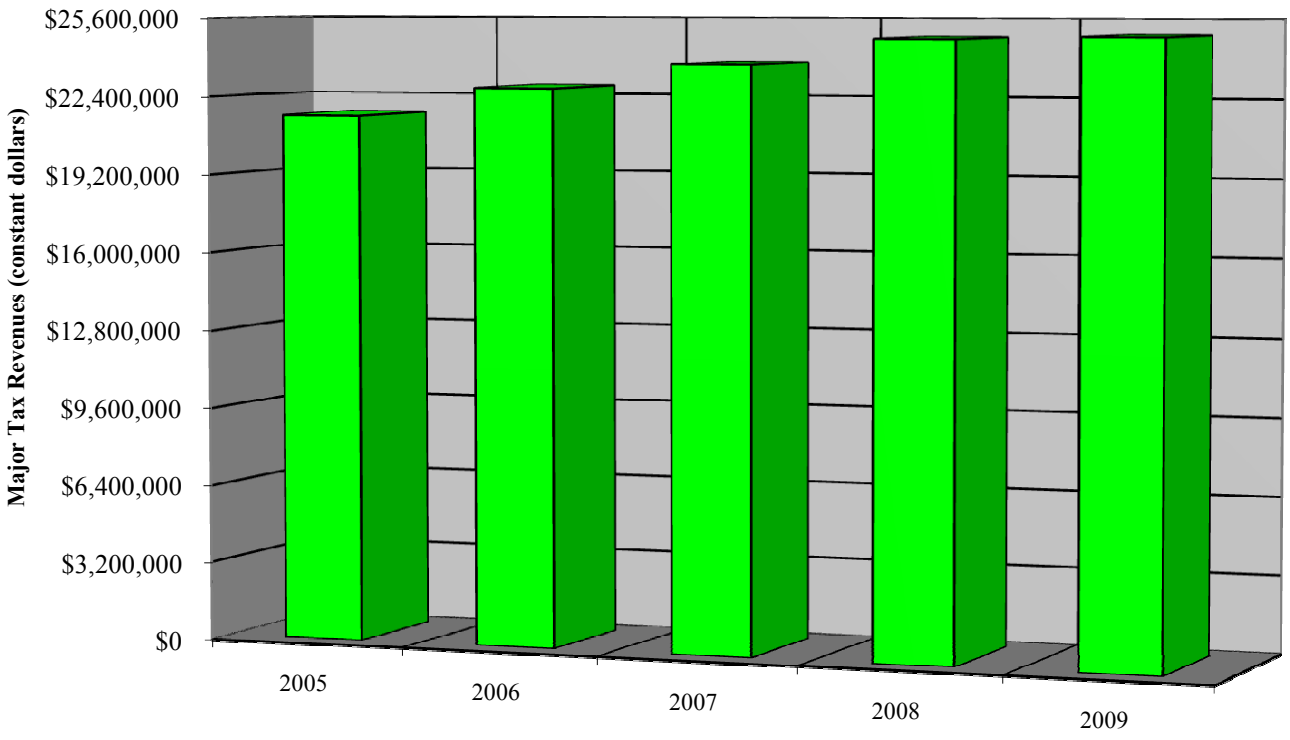
The City's major tax revenues are those taxes which the City tends to rely on the most heavily for funding its programs and services. Major tax revenues for the purpose of this indicator are real estate taxes, personal property taxes, sales and use taxes, business license taxes and restaurant food taxes.

This indicator has been increasing at a steady rate over the last five years with significant increases in 2006 and 2008 due to increased real estate assessments and in 2007 due to an increase in the personal property tax rate. Restaurant food tax collections have also had an impact on this indicator and were discussed further in Indicator 4, Elastic Revenues.

Real estate tax collections have increased 66.6% in nominal dollars (47.8% constant dollars) in the last five years. Personal property tax collections have increased 27.9% in nominal dollars (13.5% constant dollars) since 2005.

Description	2005	2006	2007	2008	2009
Major Tax Revenues (Nominal)	$39,954,436	$43,834,001	$46,929,864	$50,939,028	$51,898,673
CPI for the Area (1982-84=1.000)	1.846	1.922	1.971	2.050	2.080
Major Tax Revenues (Constant)	$21,643,790	$22,806,452	$23,810,180	$24,848,306	$24,951,285

Major Tax Revenues



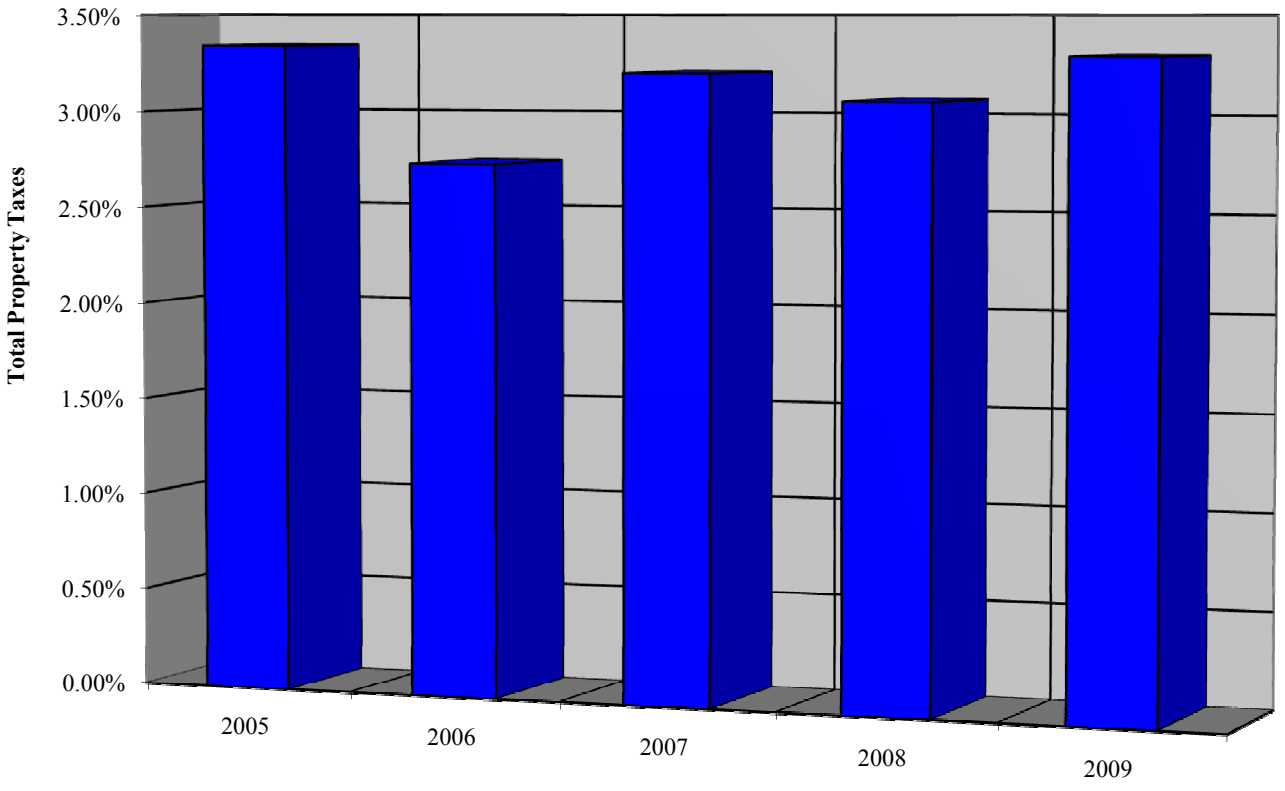
Indicator 7
Current Year Uncollected Property Taxes

Uncollected property taxes as a percentage of the property tax levy for current year taxes have been mixed over the past five years alternating increases and decreases. Credit-rating agencies assume that a locality will normally not collect from two to three percent of its property taxes within the year that the taxes are due. If current year uncollected property taxes rise to more than five to eight percent, credit-rating agencies consider this a negative factor because it signals potential problems in the stability of the property tax base. This indicator for 2009 is currently 3.30%. This may be an indication that the City's taxpayers are able to pay their taxes. This might also be an indication that the City's rate is at a reasonable level.

The City should analyze whether its collection procedures are adequate, especially in regard to delinquent taxes. If delinquency is a problem, the City may also wish to analyze the penalties charged delinquent taxpayers. If these penalties are low, taxpayers may be using the City for a low-interest source of financing for their tax bills.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Current Year Uncollected Property Taxes	$655,549	$594,606	$761,509	$836,924	$961,132
Total Property Taxes	$19,595,631	$21,683,449	$23,722,324	$27,221,485	$29,095,900
Current Year Uncollected Property Taxes as a Percentage of Total Property Taxes	3.35%	2.74%	3.21%	3.07%	3.30%

Current Year Uncollected Property Taxes



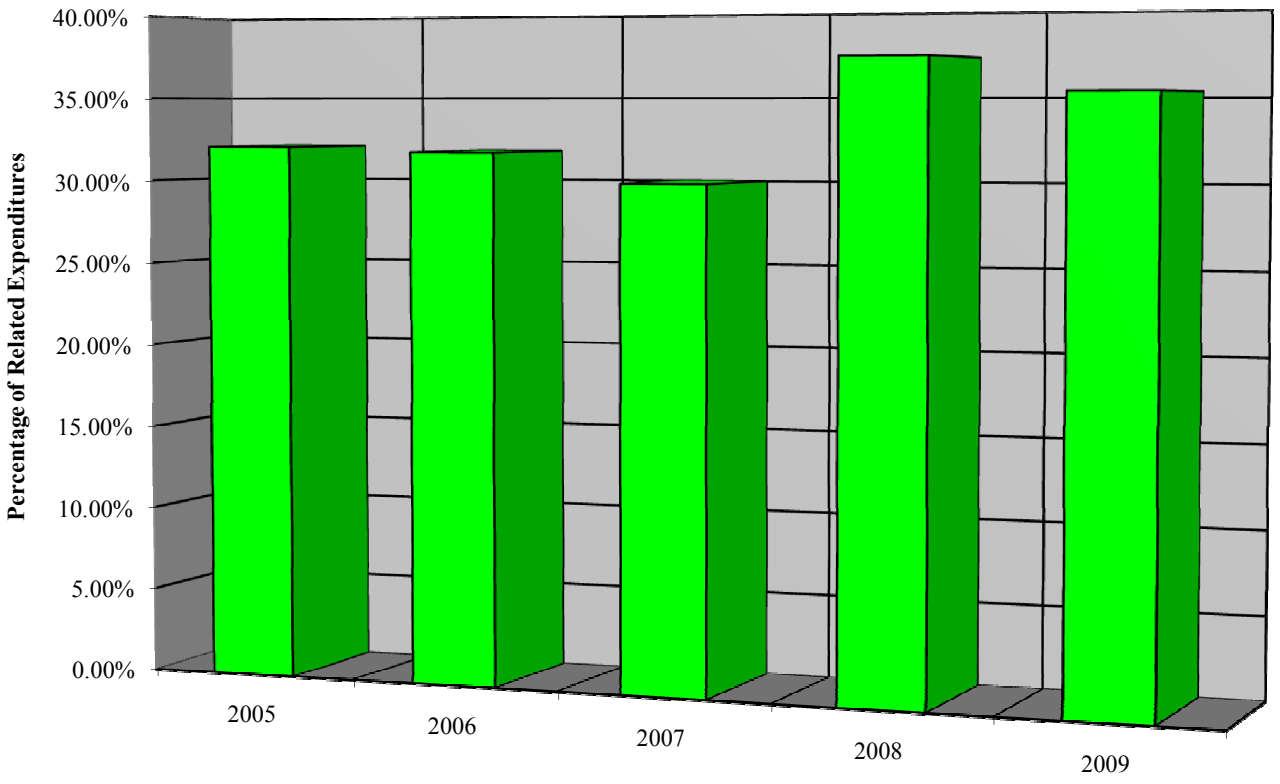
Indicator 8
User Charge Coverage

User charge coverage refers to whether or not fees and charges cover the entire cost of providing a service. A warning trend could develop as fees provided by these services begin to decrease as a percentage of the operating expenditures incurred to provide the services. The City then starts depending on general tax revenues to finance these expenditures. Expenditures used in this indicator do not include capital outlay expenditures. The idea being that user fees are generally not structured to cover these types of costs. The activities analyzed for this indicator are parks and recreation programs, golf course, building inspection and school cafeteria services.

The trend for this indicator had been decreasing from 2005 to 2007 but has increased the past two years. The sharp increase in 2008 was due to building and inspection permit revenue which more than doubled compared to 2007. This one-time increase in building permit revenue was from several large developments that received building permits during 2008. School cafeteria services have been a negative factor on this indicator declining from 37.8% coverage in 2005 to 29.5% coverage in 2009. Although it should be noted that increased federal intergovernmental revenue for school cafeteria services has made up the difference in this decline. Also during the past five years, the user charge coverage for the golf course has declined slightly from 63.7% in 2005 to 61.2% in 2009.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Revenues from User Charges	$1,614,018	$1,714,014	$1,774,966	$2,537,903	$2,467,782
Operating Expenditures for Services for which there is a Fee	$5,029,622	$5,386,224	$5,913,770	$6,782,177	$6,968,954
Revenues from User Charges as a Percentage of Related Operating Expenditures	32.09%	31.82%	30.01%	37.42%	35.41%

User Charge Coverage



Indicator 9
Revenue Surplus (Shortfall)

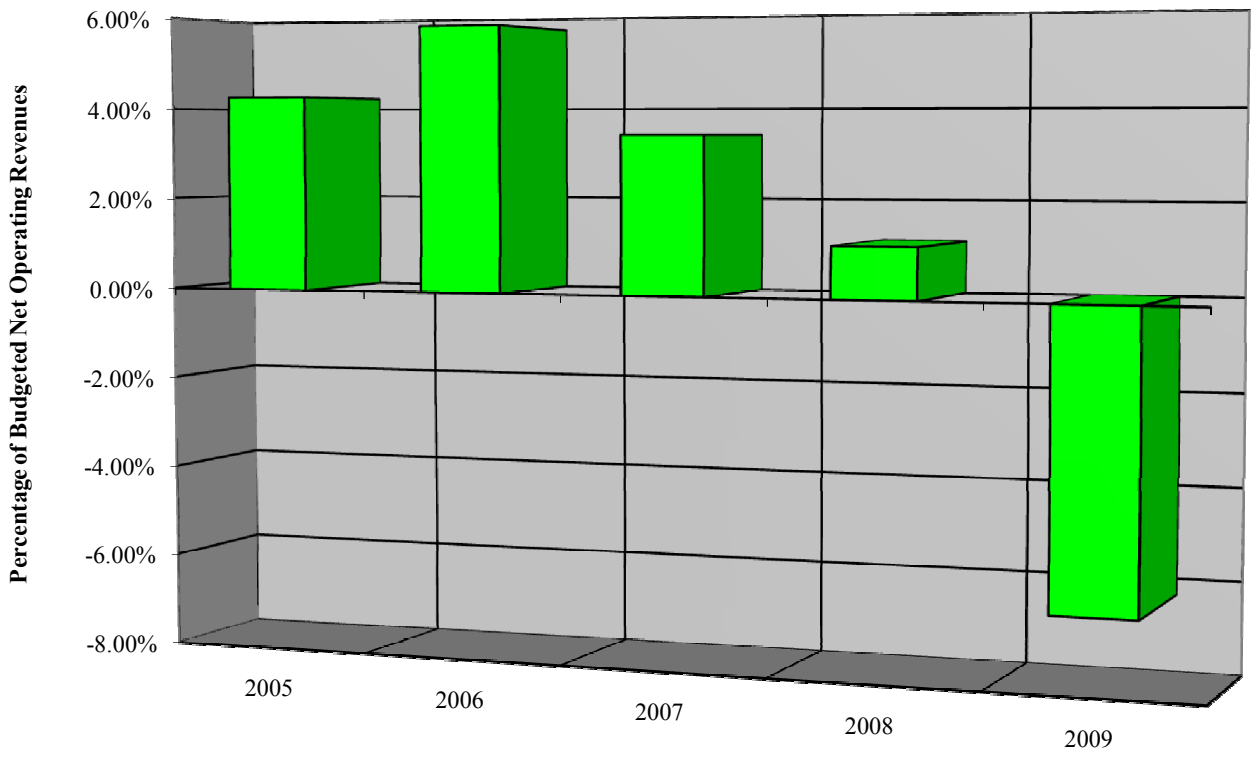
The purpose of this indicator is to examine the differences between revenue estimates and revenues actually collected during the fiscal year. Significant shortfalls that continue year after year can signal major warning trends.

Estimating revenues is a critical part of the budget process, so this area deserves attention and close scrutiny each fiscal year. Although actual revenues have exceeded budgeted revenues in four of the past five years, the trend for this indicator has been declining with a shortfall in 2009. The shortfall in 2009 was from the decline in economically sensitive revenue as a result of the weak economy. The increase in 2006 was due to the $950,000 rental payment from James Madison University for the lease of the old high school not being included in budgeted revenues. Also, actual business license tax revenue in 2006 exceeded budget estimates by approximately $670,000.

When looking at the chart below, bear in mind that a surplus is an underestimation of revenues. The budget figures quoted are for General Fund revenues only.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Actual Net Operating Revenues	$61,647,798	$67,697,891	$73,772,195	$79,005,506	$78,332,407
Budgeted Net Operating Revenues	$59,135,036	$64,014,438	$71,331,766	$78,123,298	$83,628,340
Revenue Surplus (Shortfall)	$2,512,762	$3,683,453	$2,440,429	$882,208	($5,295,933)
Revenue Surplus (Shortfall) as a Percentage of Budgeted Net Operating Revenues	4.25%	5.75%	3.42%	1.13%	(6.33%)

Revenue Surplus (Shortfall)



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Factor 2
Expenditure Indicators

The indicators developed under this factor are intended to aid the City in identifying the following types of problems:

- Excessive growth in overall expenditures as compared to growth in revenues and community wealth
- Ineffective budget controls
- A decline in personnel productivity

Indicator 11, Expenditures by Function, was not developed.

Indicator 13, Fixed Costs as a Percentage of Net Operating Expenditures, was not developed. It was felt that the usefulness of the information did not justify the difficulty in developing the ratio from existing records.

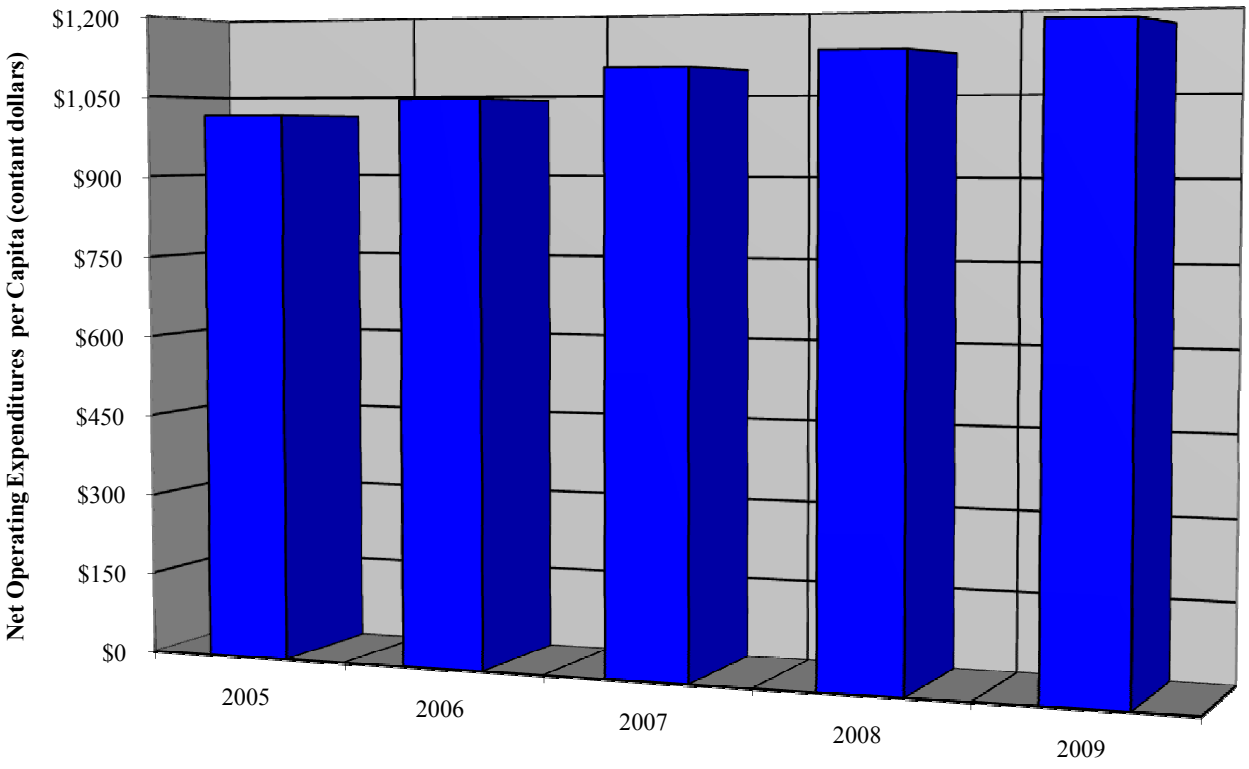
Indicator 10
Net Operating Expenditures per Capita

Net operating expenditures per capita show changes in expenditures relative to changes in population. With public opinion stronger than ever against tax increases, local governments increasingly feel the need to focus on expenditures.

Net operating expenditures per capita have increased 30.6% over the past five years in nominal dollars and 15.9% in constant dollars. This increase has mainly been due to increased spending on education and on public safety. Spending on education the last five years has increased by $15.2 million or 37.9%, while public safety has increased $5.1 million, which is a 39% increase. Debt service has also been a contributing factor to increased expenditures, increasing $4.3 million or 13.1% since 2005 mainly from the construction of the new elementary/middle school complex along with the related construction of Linda Lane.

Description	2005	2006	2007	2008	2009
Net Operating Expenditures (Nominal)	$81,749,234	$88,791,720	$97,137,129	$105,259,548	$114,581,587
CPI for the Area (1982-84=1.000)	1.846	1.922	1.971	2.050	2.080
Net Operating Expenditures (Constant)	$44,284,525	$46,197,565	$49,283,170	$51,346,121	$55,087,301
Population	43,694	44,340	44,852	45,616	46,896
Net Operating Expenditures per Capita (Nominal)	$1,871	$2,003	$2,166	$2,308	$2,443
Net Operating Expenditures per Capita (Constant)	$1,014	$1,042	$1,099	$1,126	$1,175

Net Operating Expenditures per Capita



Indicator 12
Employees per Capita

The purpose of this indicator is to determine if a trend of increasing employees is occurring, which might indicate that government is becoming more labor intensive or that personnel productivity is declining. Employee figures are the budgeted full-time equivalent (FTE) positions for that year.

The actual number of FTE's has increased each of the previous five years with a total five-year increase of 83.1 FTEs (15%), while the trend of employees (FTEs) per 1,000 residents has had a more gradual increase. The five-year increase consisted of 13.1 new police personnel; 13.1 new fire personnel; 10 public transportation personnel; 8.2 public works personnel; 6.8 economic development personnel; 6.5 sanitation personnel; and, other minor changes in other City departments.

Description	2005	2006	2007	2008	2009
Number of Employees (Full-time Equivalents)	555.6	571.9	595.2	613.9	638.7
Population	43,694	44,340	44,852	45,616	46,896
Municipal Employees per 1,000 Residents	12.72	12.90	13.27	13.46	13.62

Municipal Employees
(Full-time Equivalents)
By Department

Department[1]	2005	2006	2007	2008	2009
Clerk of Council	1	1	1	1	1
City Manager	4.2	4.2	4.4	4.4	4.7
City Attorney	-	1	1	1	1
Human Resources	2.5	2.7	2.7	3.0	3.0
Commissioner of the Revenue	10	10.4	11.5	11.5	11.7
Treasurer	7	7	7	7	7.7
Finance	7	7	7	7.4	7.4
Information Technology	4	3.3	4.8	6.4	7.4
Registrar	2.2	2.4	2.4	2.2	2.2
Police	98.7	102.8[2]	102.6	108.8[6]	111.8
Fire	69.7	73[3]	74.3	78.8[7]	82.8[7]
Public Works	53.7	54.4	60.9[4]	60.9	61.9
Parks and Recreation	65.6	66.8	69.4	70.6	71.2
Planning and Community Development	25.9	27.1	28.2	28.4	29.3
Economic Development	5.1	5.1	11.9[5]	9.6	11.9
Community Development Block Grant	1	1	1	1.6	1.5
Public Utilities	52.6	52.6	53.4	54.0	56.9
Public Transportation	76.4	79.2	79.8	78.6	86.4[8]
Sanitation	55	56.9	56.9	60.9	61.5
Central Garage	13	13	13	15.8	15.4
Central Stores	1	1	2	2	2
TOTAL	555.6	571.9	595.2	613.9	638.7

[1] Figures do not include boards and commissions.
[2] Reflects hiring an additional investigator and a crime prevention specialist.
[3] Reflects hiring three new firefighters.
[4] Reflects hiring of additional traffic engineering and street cleaning personnel.
[5] Reflects the addition of tourism and visitors services personnel.
[6] Reflects hiring four new police officers and an additional investigator.
[7] Reflects hiring six new firefighters and a computer program administrator during 2008 and 2009.
[8] Reflects hiring additional bus drivers.

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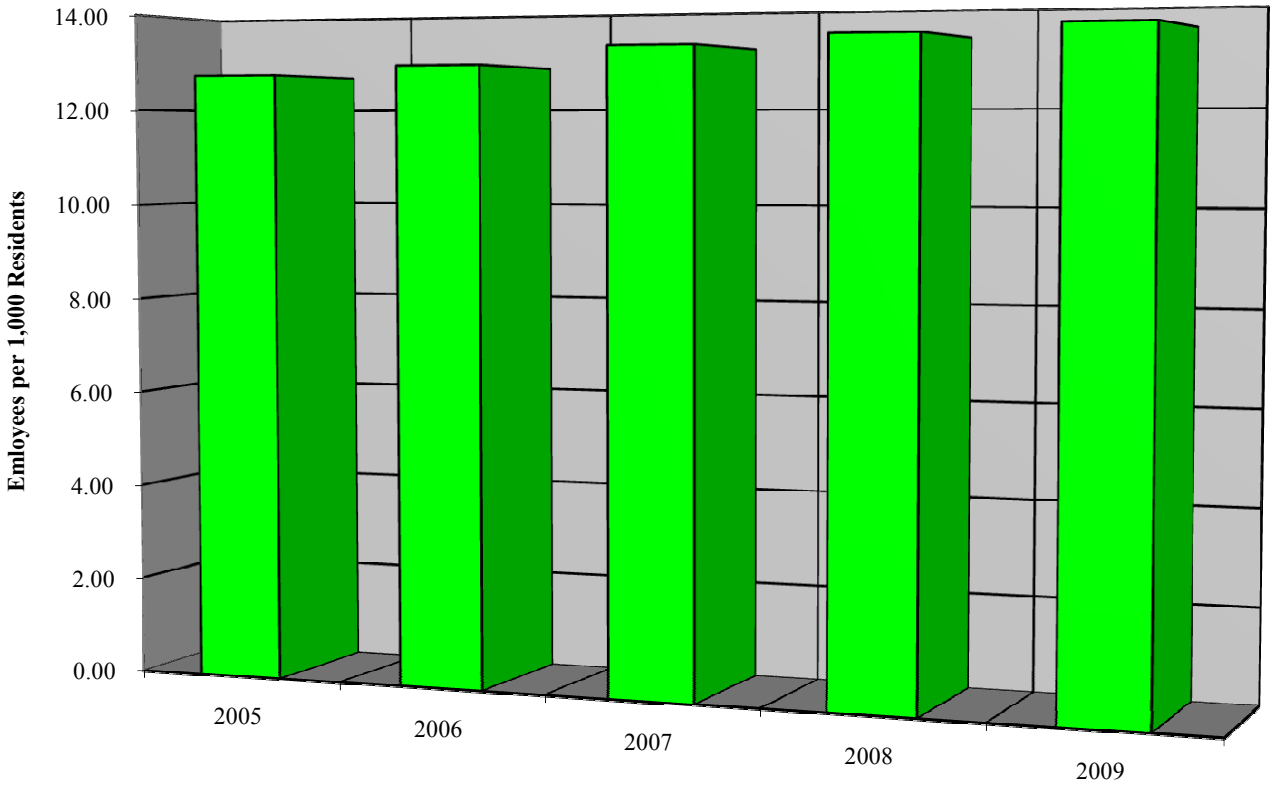
Employees per Capita



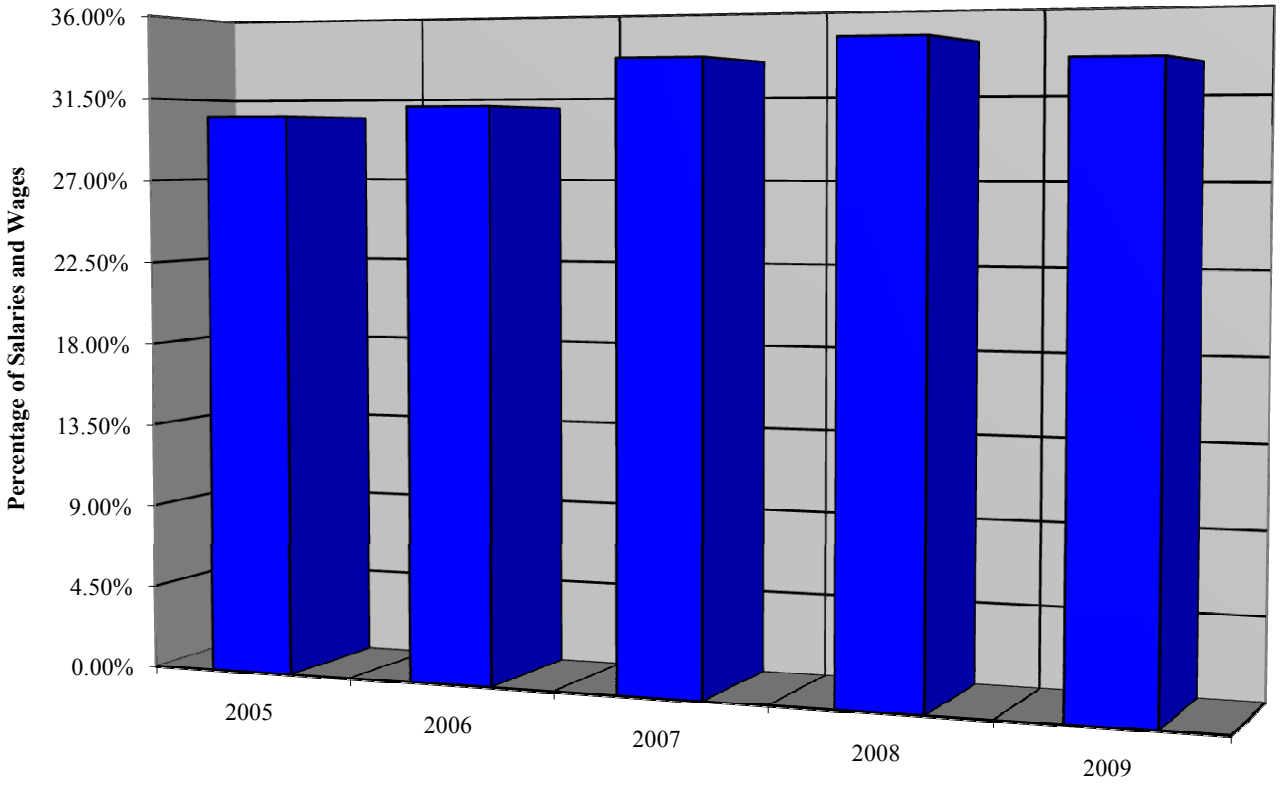
Indicator 14
Fringe Benefits

The ICMA Handbook explains that this indicator can be helpful in guiding policy because fringe benefits can be difficult to quantify in the normal budgeting process. As a result, these costs can escalate unnoticed while straining finances. The City's primary fringe benefit expenditures consist of VRS retirement, VRS life insurance, health insurance, and employer's share of FICA. While accumulated vacation and sick leave are considered employee or fringe benefits, these benefits are not recorded as expenditures until actually paid.

This trend has been increasing since 2005 with a modest decline in 2009 due to a decrease in required VRS retirement contribution rates for both the City and the School. VRS retirement rates had been increasing from 2005 to 2008 in order to compensate for plan asset losses incurred earlier in the decade and increased benefits for public safety employees which contributed to an increasing trend for this indicator during those years. Health insurance expenditures remained essentially flat from 2005 to 2007 which helped offset the increasing VRS expenditures during that time period but increased the last two years as the result of five percent premium increases in each of these years.

Description	2005	2006	2007	2008	2009
Expenditures for Fringe Benefits	$11,634,509	$12,455,880	$14,470,018	$15,967,472	$16,486,388
Salaries and Wages	$38,144,714	$40,177,603	$43,240,521	$46,416,102	$49,563,489
Fringe Benefit Expenditure as a Percentage of Salaries and Wages	30.50%	31.00%	33.46%	34.40%	33.26%

Fringe Benefits



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Factor 3
Operating Position Indicators

The indicators developed under this factor are intended to aid the City in assessing its operating position. Specifically, operating position refers to a government's ability to balance its budget and pay its bills.

Analyzing operating position can help a City identify the following types of problems:

- Continuing operating deficits
- A decline in unrestricted reserves
- A decline in liquidity (its cash position)
- Ineffective forecasting techniques
- Ineffective budget controls

Indicator 15
Operating Surplus (Deficit)

Operating results are important indicators of a City's financial position. When current year expenditures exceed the current year's revenues, an operating deficit occurs. This does not mean that the City is operating on a budget deficit. Reserves from prior years may be used to offset a current year budget deficit. If the trend continues, the financial condition of the municipality may deteriorate, and the City will need more revenues to meet the increasing amount of expenditures. Increasing operating deficits from year to year are usually considered negative factors in analyzing financial condition, but many political and environmental factors play a part in the budgeting process, so that mere reduction of expenditures and/or increasing revenues may not be the most desirable solutions. Since this indicator focuses on operating results, significant one-time revenues and expenditures have been eliminated.

The General Fund has had operating deficits in each of the past five years. The deficits in 2005, 2006 and 2008 were mainly due to the use of undesignated fund balance to fund expenditures. The deficit in 2007 was due to approximately $3.7 million in transfers to the General Capital Projects Fund for road projects. The significant deficit in 2009 was the result of a decline in revenue from the weak economy and the use of $4.2 million of undesignated funds balance to balance the 2009 budget.

The Special Revenue Funds have had operating surpluses in four of the last five years. The operating deficit in 2009 was due to $1.6 million being returned to the General Fund from the School Fund’s fund balance.

Description	2005	2006	2007	2008	2009
General Fund Operating Surplus (Deficit)	($519,172)	($452,713)	($2,624,157)	($1,404,168)	($6,454,157)
General Fund Net Operating Revenues	$61,647,798	$67,697,891	$73,772,195	$78,742,656	$78,332,407
General Fund Surplus (Deficit) as a Percentage of Net Operating Revenues	(0.84%)	(0.67%)	(3.56%)	(1.78%)	(8.24%)
Special Revenue Funds Operating Surplus (Deficit)	$499,763	$318,724	$244,960	$1,105,528	($172,302)
Special Revenue Funds Net Operating Revenues	$22,381,659	$24,242,674	$28,912,572	$29,100,273	$31,027,169
Special Revenue Funds Surplus (Deficit) as a Percentage of Net Operating Revenues	2.23%	1.31%	0.85%	3.80%	(.56%)

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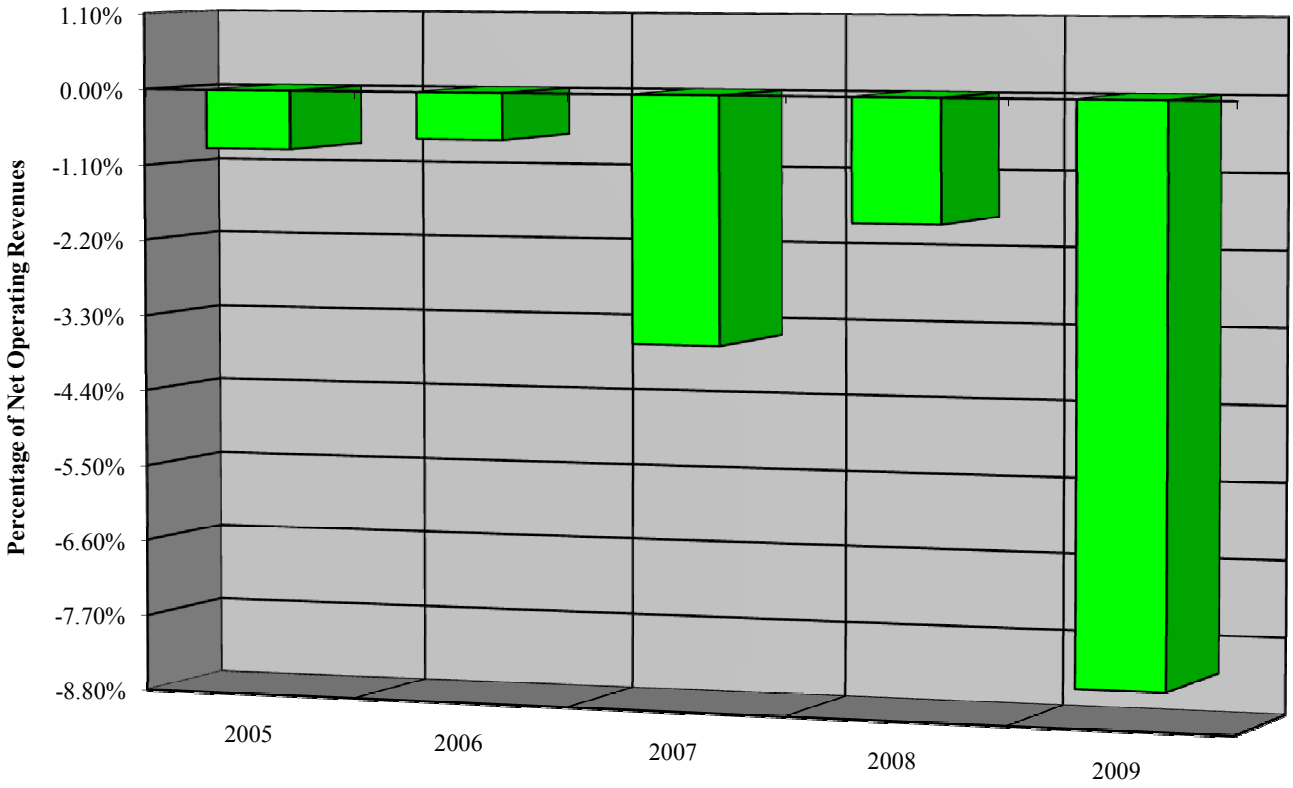
Operating Surplus (Deficit)
(General Fund)



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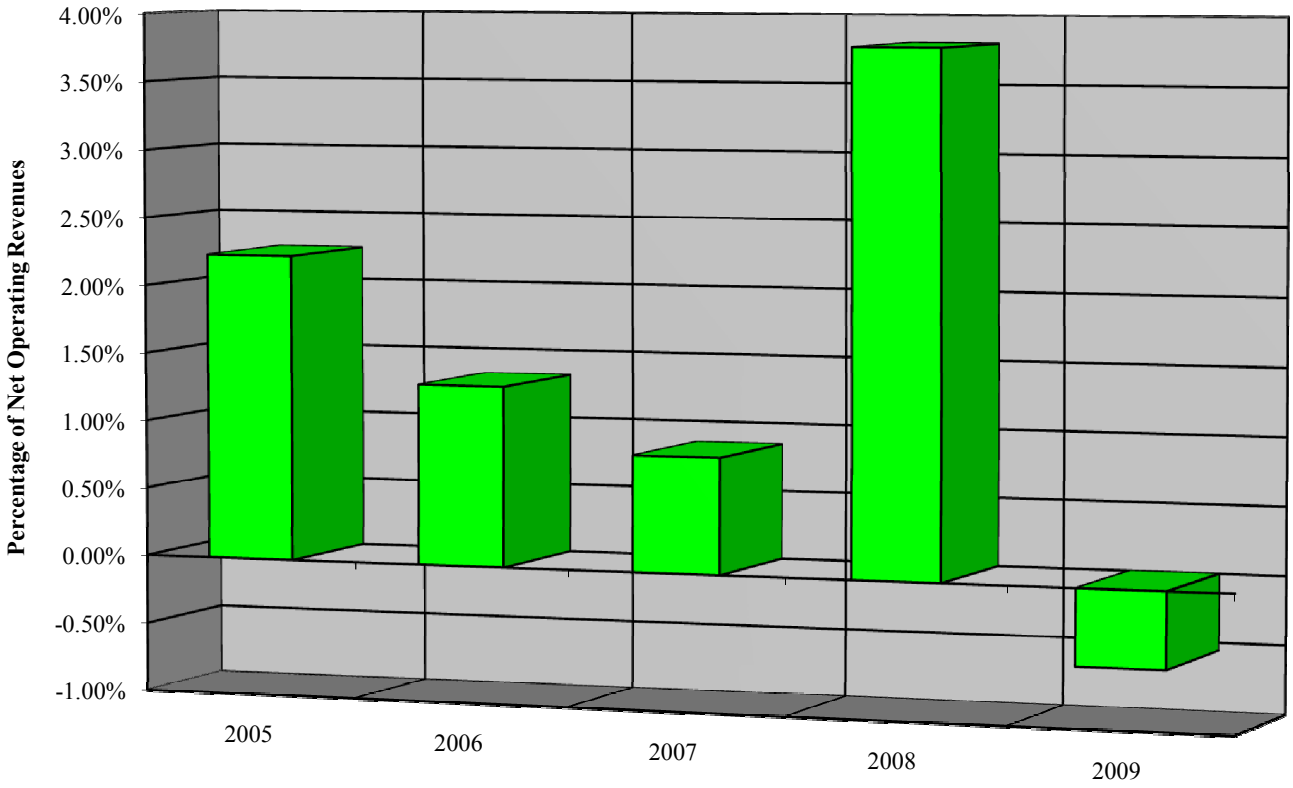
Operating Surplus (Deficit)
(Special Revenue Funds)



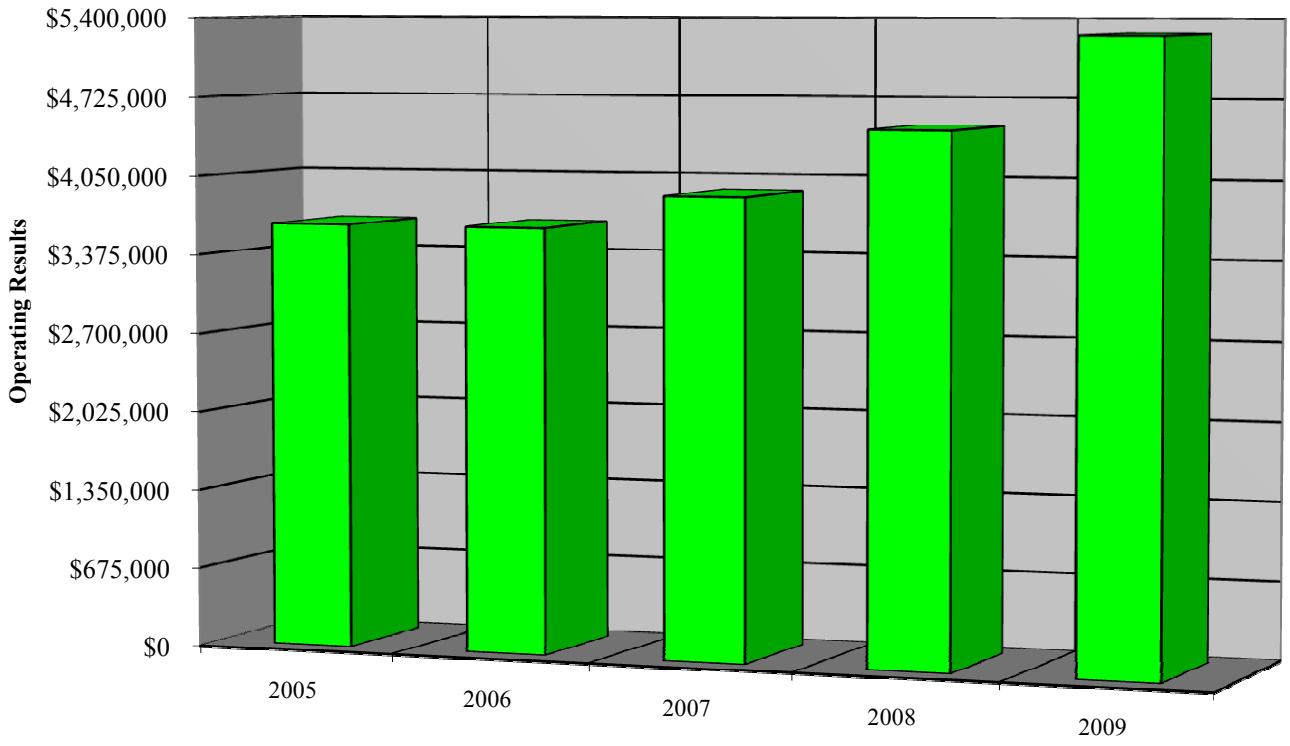
Indicator 16
Enterprise Fund Operating Results

Enterprise Funds operating results have been trending up since 2005. The overall increase in the indicator has mainly been the result of a combination of two factors. First, continued positive operating results in the Water Fund due to rate increases enacted over the past five years. Second, increasing revenue in the Sanitation Fund has more than offset increasing expenses. Revenue in the Sanitation Fund has increased $3.7 million (57.6%) while expenses have increased $2.1 million. There are several factors that are having negative impacts on this factor. Operating and debt service contributions to the Harrisonburg-Rockingham Regional Sewer Authority from the Sewer Fund have increased 54.7%. The City has been increasing sewer authority revenue rates to offset these increased contributions to the Regional Sewer Authority. Also, Public Transportation Fund expenses have increased for personal services and fringe benefits (29.7%); and, fuel expenses have increased (72.3%) mainly due to an increase in fuel prices.

Enterprise Fund net income is the result of these funds covering the "user charge" for the services they render. If transfers from the General Fund substantially support an Enterprise Fund, the Enterprise Fund probably needs to consider charging user fees or increasing the fees already charged. The figures shown below are for the City's primary government Enterprise Funds and reflect operating income (loss) and operating grants less depreciation, amortization and one-time charges.

Description	2005	2006	2007	2008	2009
Enterprise Fund Operating Results (Nominal)	$3,637,513	$3,635,385	$3,923,093	$4,491,577	$5,279,977

Enterprise Fund Operating Results



Indicator 17
Undesignated Fund Balances

Maintenance of a sufficient undesignated fund balance allows local governments to have adequate funds on hand to operate throughout the year, including periods of low revenue collections. The size of the undesignated fund balance can affect the City's ability to withstand financial emergencies and short-term revenue losses due to actions by other levels of government. It can also be used to accumulate funds for capital purchases without incurring debt. An appropriate fund balance also helps in securing and maintaining better credit ratings, which result in lower borrowing costs. As a result, taxes and other user rates can be lower than otherwise would be necessary.

Rating agencies typically recommend a minimum fund balance of 5% of the budget. A smaller balance may be justified by a long-term trend of annual budget surpluses. A much larger balance may be warranted, especially if budget revenues and expenses are economically sensitive or otherwise not easily forecasted. Rating agencies tend to look unfavorably on large swings in the percentage and especially on unplanned declines. Decreasing fund balances are warning trends because the City may not be able to meet its future needs unless more revenues are generated. The City has taken a proactive approach to preserve the General Fund's undesignated fund balance through the adoption of the City's Financial Management Policies. It is the City's policy to maintain an undesignated fund balance of no less than 10% of the General Fund budget plus adequate funds for working capital purposes, which is typically considered 4%.

Undesignated fund balance as a percentage of net operating revenues for the General Fund has been trending upwards over the past five years. The increase in 2007 was due to the sale of the old Harrisonburg High School complex. Although there were operating deficits in the General Fund in 2008 and 2009, as noted in Indicator 15, Operating Surplus (Deficit), this indicator still increased the past two years. The 2010 budget did not require the use of undesignated fund balance to balance the

budget which offset the impact of the operating deficit in 2009 while the sale of the land on Port Republic Road offset the impact of the operating deficit in 2008.

While undesignated fund balance as a percentage of net operating revenues for the Special Revenue Funds had generally been trending up from 2005 to 2008, the indicator did decrease in 2009 mainly due to $1.6 million being returned to the General Fund from the School Fund's fund balance.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Undesignated Fund Balance (General Fund)	$10,877,629	$10,790,588	$14,651,441	$15,682,461	$16,466,581
Net Operating Revenues	$61,647,798	$67,697,891	$73,772,195	$78,742,656	$78,332,407
Undesignated Fund Balance as a Percentage of Net Operating Revenues	17.64%	15.94%	19.86%	19.92%	21.02%
Undesignated Fund Balance (Special Revenue Funds)	$3,246,866	$3,559,757	$4,136,921	$4,824,674	$4,226,813
Net Operating Revenues	$22,381,659	$24,242,674	$28,912,572	$29,100,273	$31,027,169
Undesignated Fund Balance as a Percentage of Net Operating Revenues	14.51%	14.68%	14.31%	16.58%	13.62%

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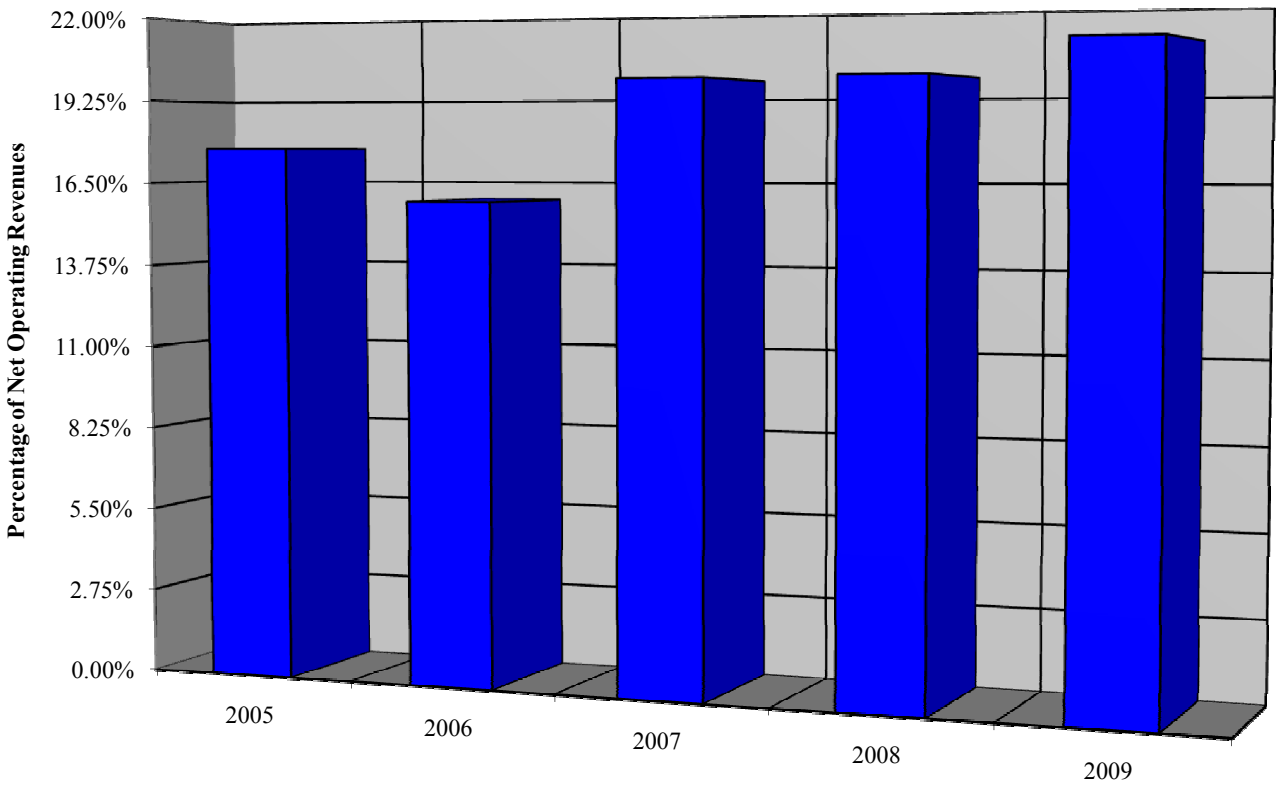
Undesignated Fund Balances
(General Fund)



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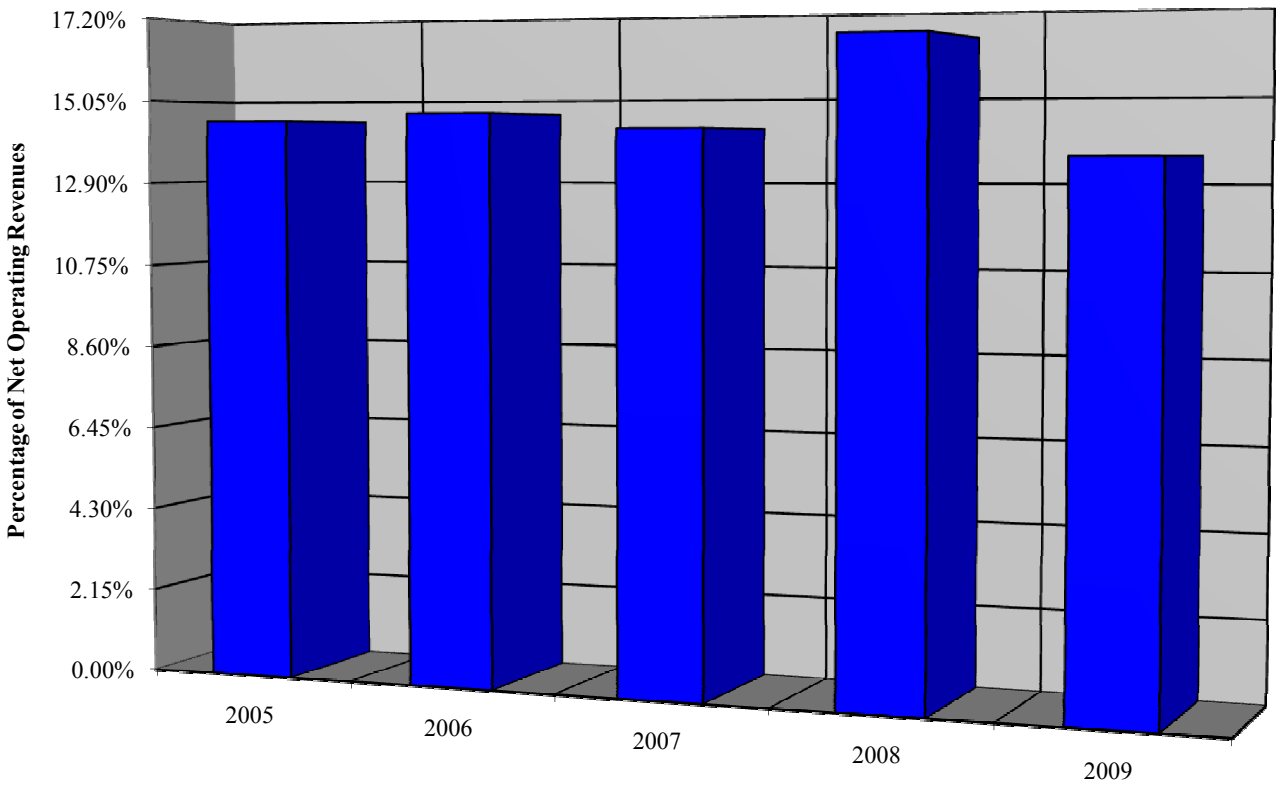
Undesignated Fund Balances
(Special Revenue Funds)



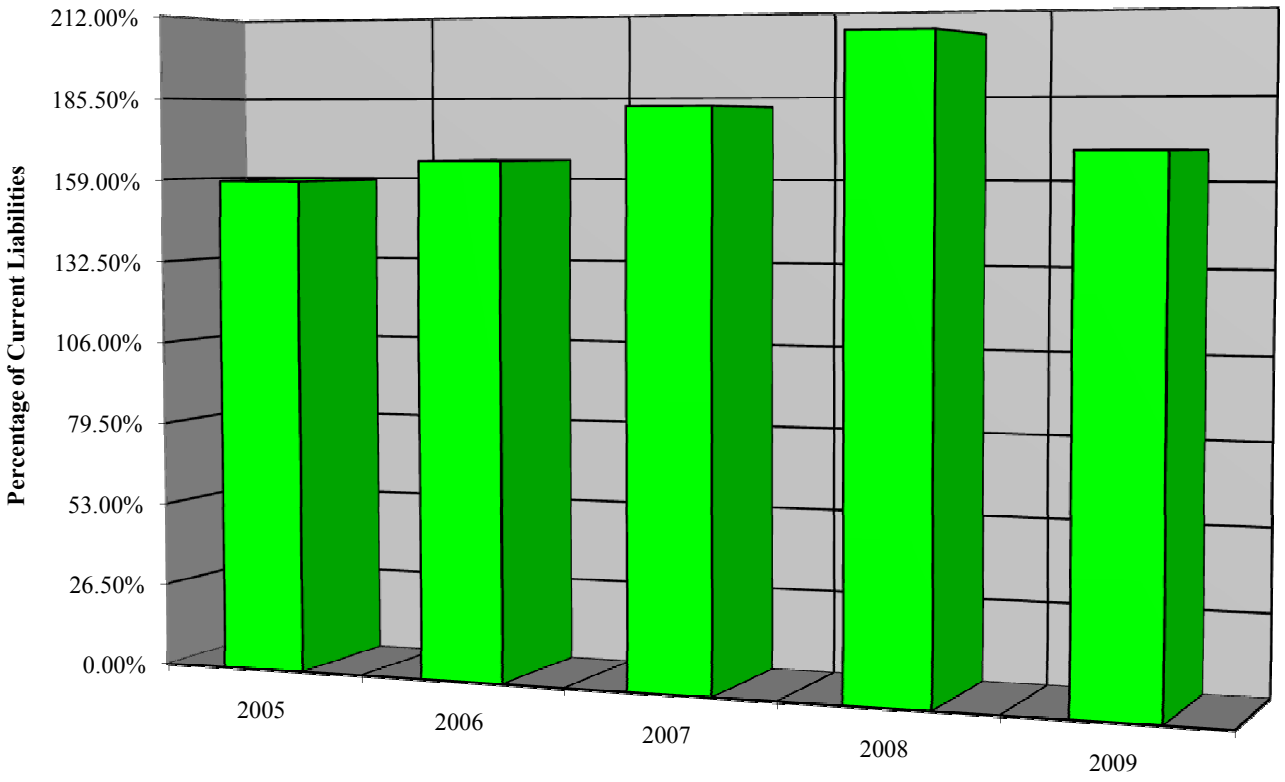
Indicator 18
Liquidity

A good measure of a local government's short-term financial condition is its cash position. Cash position, which includes cash and short-term investments, determines a government's ability to pay its short-term obligations. The credit industry benchmark of less than a one to one ratio is considered a negative factor with three or more years being an extreme negative factor. The City continues to be in a healthy cash position. The indicator decreased rather sharply in 2009 after trending upwards the previous four years with significant increases in 2007 and 2008. The 2007 increase was due to an increase in the City's cash position from the sale of the old Harrisonburg High School complex while the 2008 increase was due to the sale of land on Port Republic Road. The decline in 2009 was due to decreasing revenue and the use of fund balance reserves resulting from current weak economic conditions.

However, it is not uncommon for a City the size of Harrisonburg to experience fluctuations in its cash position over the course of a year. The ultimate goal is to manage cash effectively to prevent insolvency. The City has adopted cash management policies and procedures to prevent any unfavorable situations.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Cash and Cash Equivalents	$18,107,301	$18,613,221	$28,362,734	$30,433,732	$24,874,798
Current Liabilities	$11,429,990	$11,269,119	$15,561,769	$14,850,076	$14,724,509
Cash and Short-term Investments as a Percentage of Current Liabilities	158.42%	165.17%	182.26%	204.94%	168.93%

Liquidity


Percentage of Current Liabilities
212.00%
185.50%
159.00%
132.50%
106.00%
79.50%
53.00%
26.50%
0.00%
2005
2006
2007
2008
2009

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Factor 4
Debt Indicators

The indicators developed under this factor are intended to aid the City in monitoring changes in debt structure. The overriding concern is to ensure that the City's outstanding debt does not exceed its ability to repay in a worst-case scenario. Specific considerations to be analyzed include determining whether or not debt is (1) proportional in size and rate of growth to its tax base, (2) extends past the useful life of the facilities it finances, (3) used to finance the operating budget, (4) requires repayment schedules that put excessive burdens on operating expenditures, and (5) so high as to jeopardize the City's credit rating.

Indicator 22, Overlapping Debt, was not developed because the City does not have overlapping debt.

Indicator 19
Current Liabilities

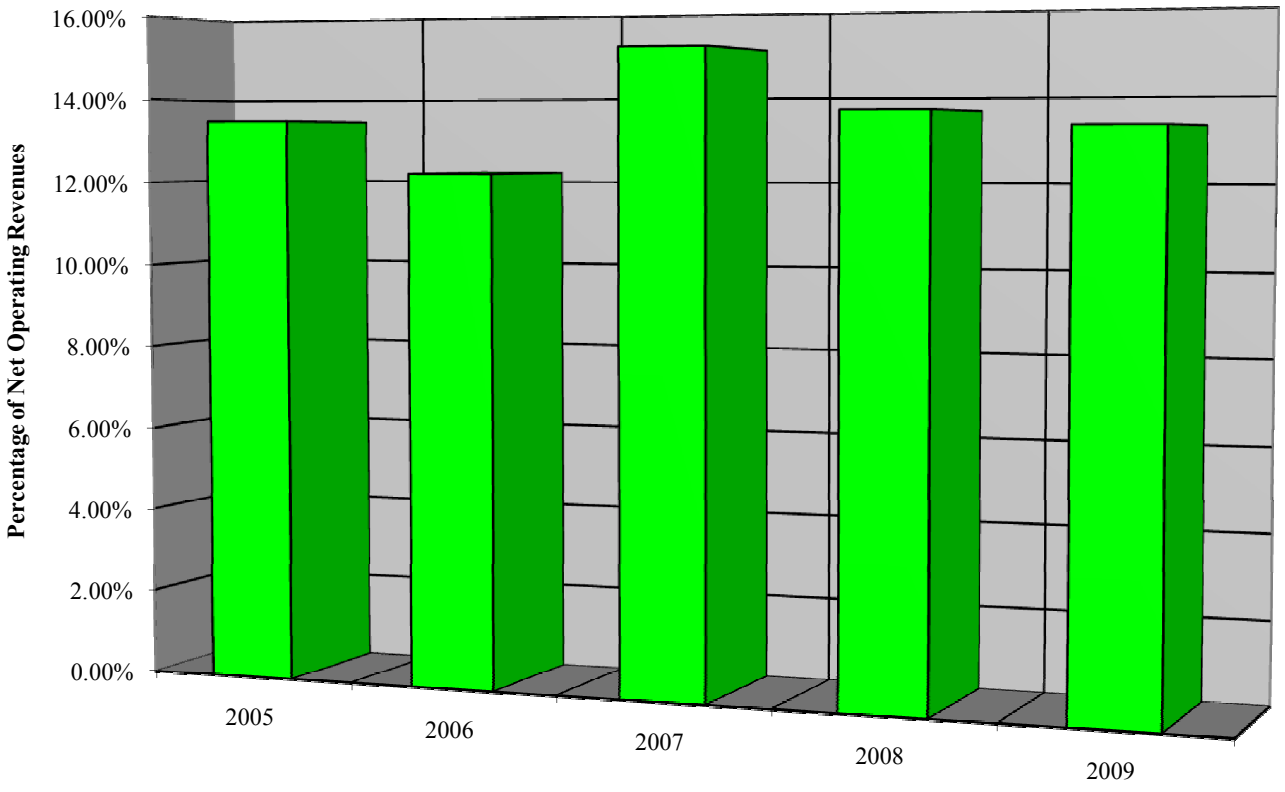
Current liabilities are the sum of all liabilities due at the end of the fiscal year and principal on long-term debt that is due the following year. This indicator is mainly concerned with identifying whether increasing levels of short-term borrowing are being used to finance deficit spending and/or mask liquidity problems.

The warning trend identified by the Handbook is an increasing ratio of current liabilities to net operating revenues. This indicator has been trending downward the last two years after a significant increase in 2007. The increase in 2007 was due to a $1.7 million loan guarantee on behalf of the Boys and Girls Club and the ARC that was associated with the Simms Continuing Education Center. A second factor was a $1.5 million liability for accrued interest on the October 2006 $50 million bond issue.

Two credit industry benchmarks considered negative factors are (1) short-term debt outstanding at the end of the year exceeding 5% of operating revenues, and (2) a two-year trend of increasing short-term debt outstanding at the end of the fiscal year. The City does not have any short-term borrowings and is not in violation of either benchmark. The Handbook suggests adopting policies, which will prohibit these situations from occurring.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Current Liabilities	$11,429,990	$11,269,119	$15,561,769	$14,850,076	$14,724,509
Net Operating Revenues	$84,859,232	$92,132,547	$102,684,767	$108,435,524	$110,186,518
Current Liabilities as a Percentage of Net Operating Revenues	13.47%	12.23%	15.15%	13.69%	13.36%

Current Liabilities



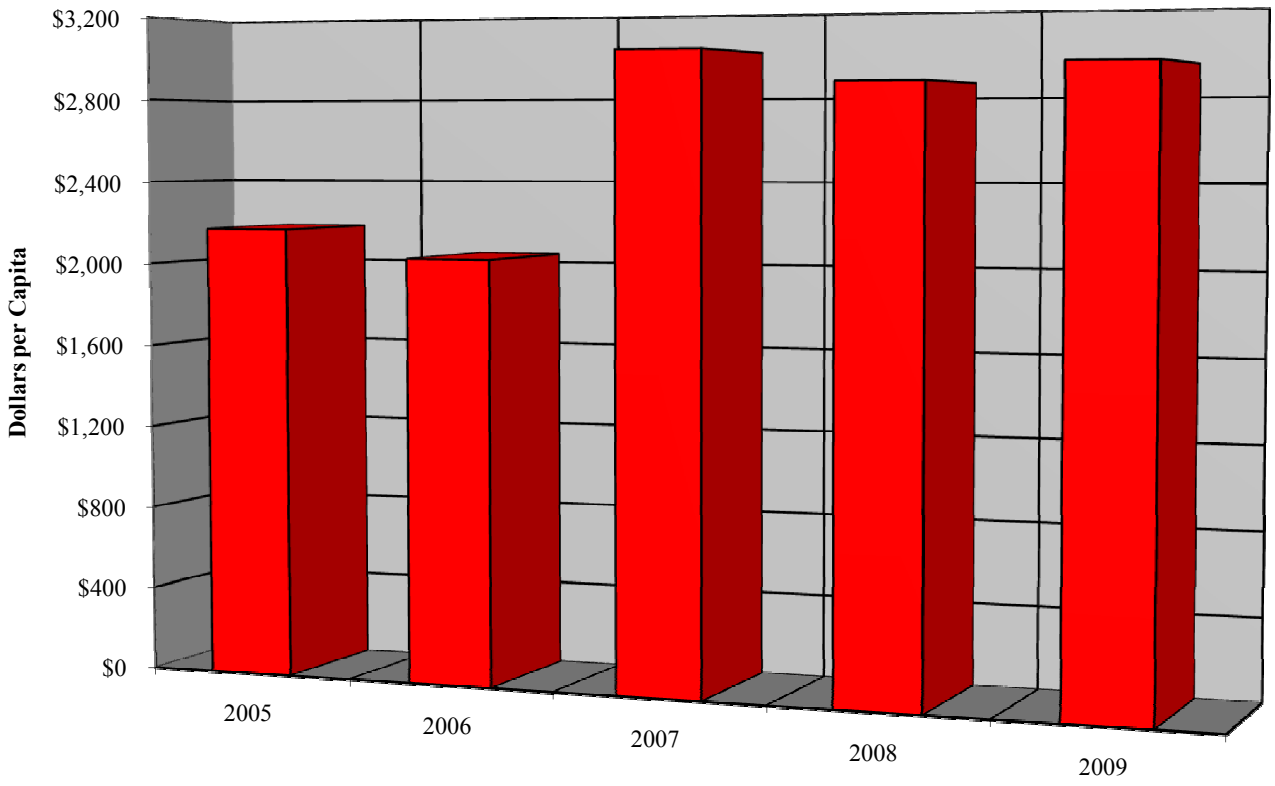
Indicator 20
Long - Term Debt

This indicator is used to help assess whether local government resources are adequate to pay its long-term debt. This indicator is computed by comparing net direct general long-term debt to assessed real property valuation and also to population. The assessed valuation of real property in the City is used with the assumption that real property taxes will be the primary source of debt repayment.

This indicator has been decreasing overall the past five years as a percentage of assessed real property valuation, while the per capita trend has been increasing. The indicator as a percentage of assessed real property valuation did decline sharply in 2006 and 2008 compared to the per capita indicator due to an approximate 15% and 36% increase in property value reassessments, respectively. The increase in 2007 was due to the October 2006 $50 million school and road projects bond issue. The ICMA Handbook suggests that an increasing indicator is a warning trend, but it also points out that a credit industry benchmark warning signal is when debt exceeds ten percent of assessed real property valuation. The City's ratio is currently 3.97%.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Long-term Debt	$94,928,608	$90,439,175	$135,554,145	$130,960,058	$138,679,660
Population	43,694	44,340	44,852	45,616	46,896
Long-term Debt per Capita	$2,173	$2,040	$3,022	$2,871	$2,957
Assessed Real Property Valuation	$2,023,137,618	$2,327,029,514	$2,397,653,625	$3,252,988,206	$3,496,364,495
Long-term Debt as a Percentage of Assessed Real Property Valuation	4.69%	3.89%	5.65%	4.03%	3.97%

Long-Term Debt per Capita



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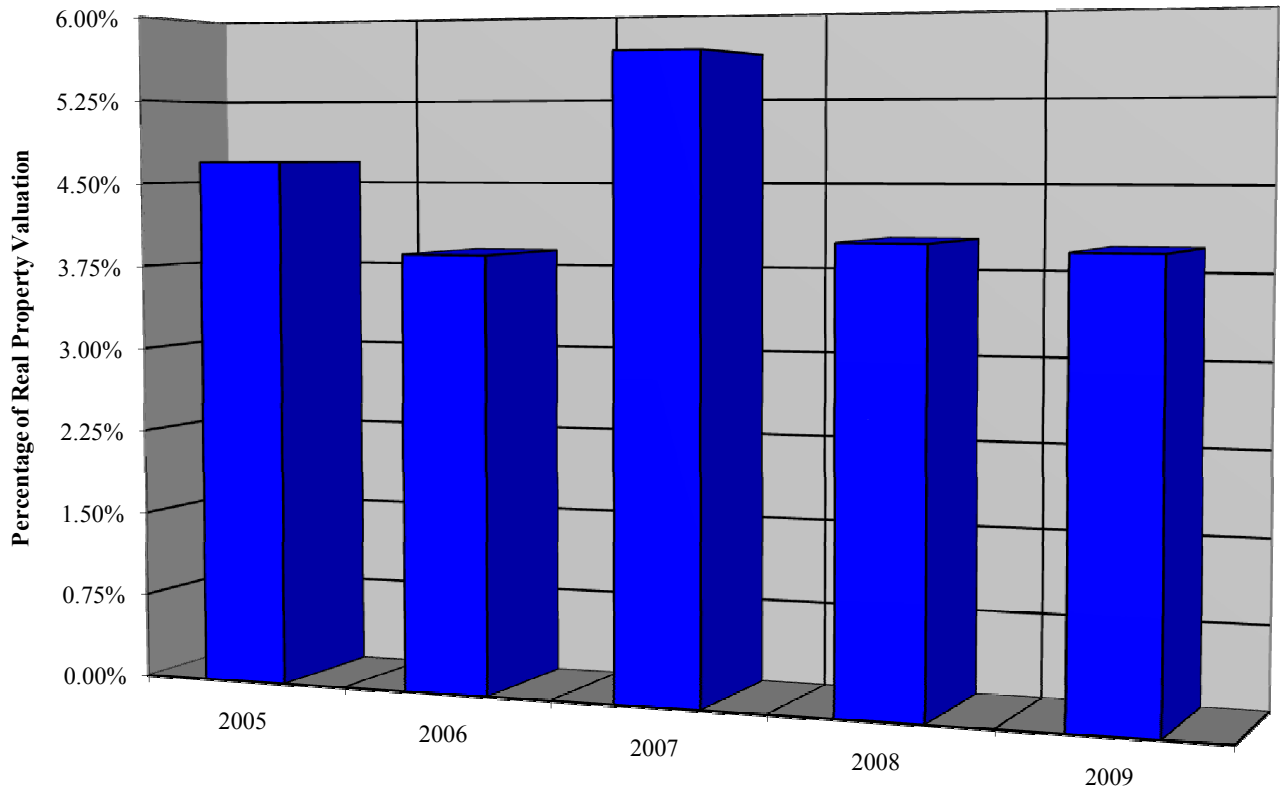
Long-Term Debt as a Percentage of Real PropertyValuation



Indicator 21
Debt Service

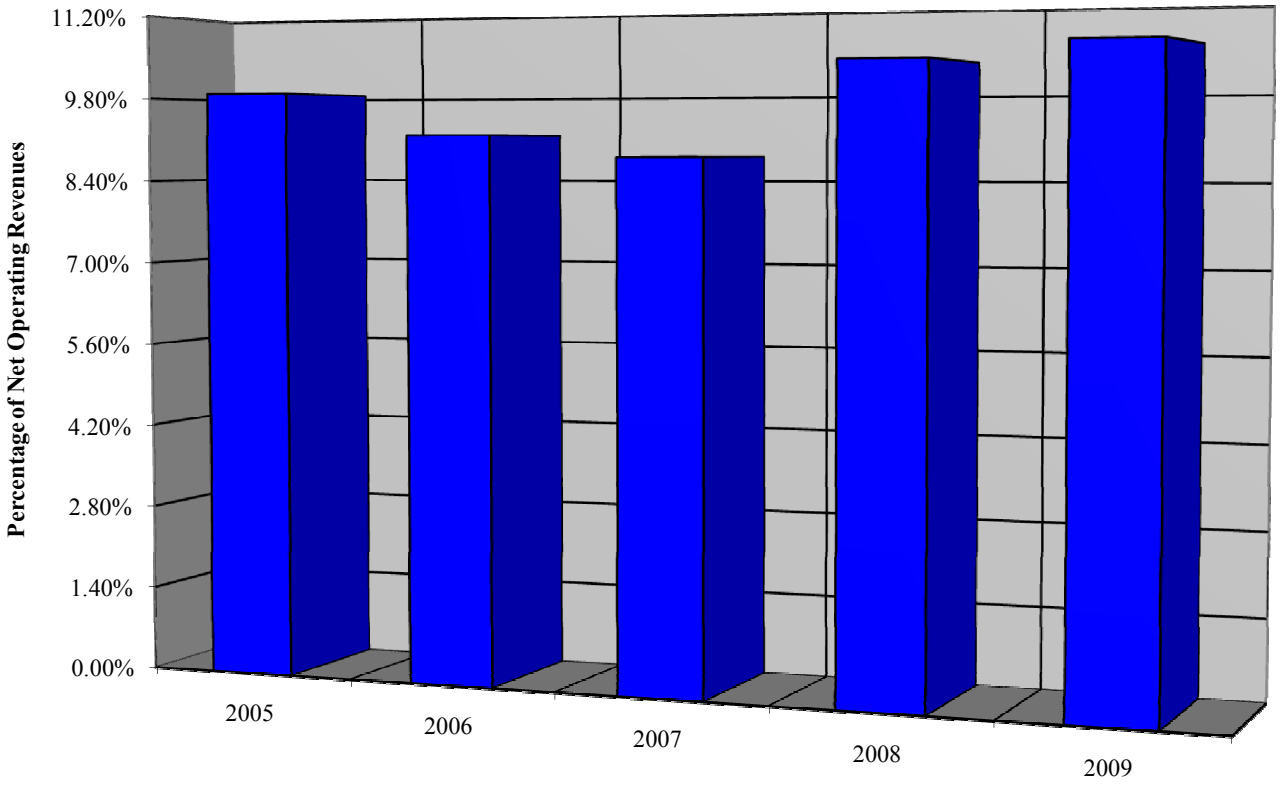
This indicator is determined by comparing the amount of the City's debt principal and interest payments for the year to its net operating revenues. The primary purpose of this indicator is to determine the effect of debt on the flexibility of expenditures, since debt service can be a major part of a government's fixed costs.

This indicator had been decreasing from 2005 through 2007 but has increased the past two years. The sharp increase in 2008 was due to the first debt service payment from the October 2006 $50 million bond issue. The ICMA Handbook calls an increasing indicator a warning trend, but it also indicates that the credit industry warning benchmark is 20 percent with 10 percent considered acceptable. This indicator for 2009 was above 10 percent at 10.65%.

The policy implications are generally the same as those for Indicator 19 with the additional suggestion that the effect of debt service on annual fixed cost be analyzed prior to the issuance of bonded long-term debt.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Debt Service	$8,381,066	$8,458,117	$9,052,145	$11,250,785	$11,729,847
Net Operating Revenues	$84,859,232	$92,132,547	$102,684,767	$108,435,524	$110,186,518
Debt Service as a Percentage of Net Operating Revenues	9.88%	9.18%	8.82%	10.38%	10.65%

Debt Service



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Factor 5
Unfunded Liability Indicators

Unfunded liabilities are those which have been incurred prior to the balance sheet date, are not payable until a future date and for which reserves have not been set aside.

Pension and employee leave liabilities are the unfunded liabilities considered under this factor. Because the City has no policy control over the Virginia Retirement System, we did not develop Indicators 23 and 24 relating to pension obligations and assets. Developing these indicators would not disclose any information, which is not already highlighted in the Defined Benefit Pension Plan note to the financial statements contained in the City's Comprehensive Annual Financial Report.

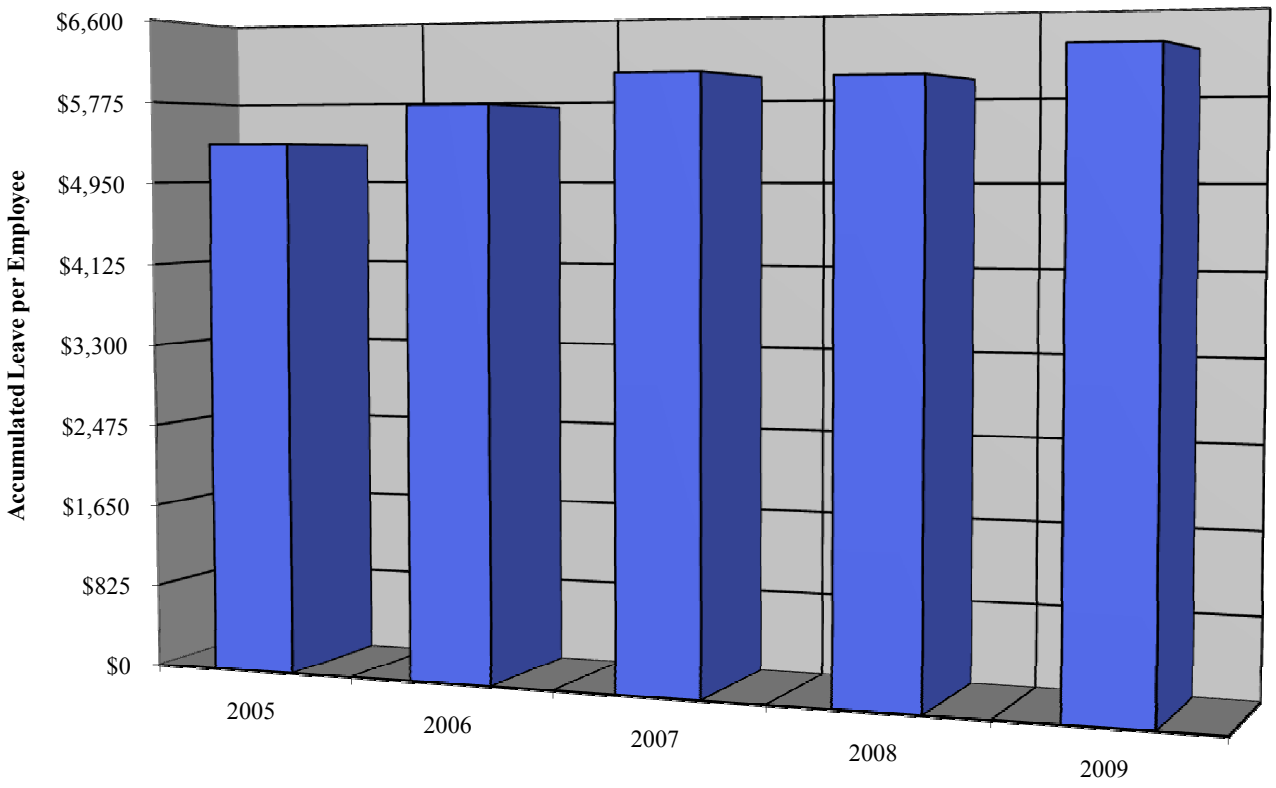
Indicator 25
Accumulated Employee Leave

Accumulated employee leave is the dollar value of all unused vacation and sick leave benefits. This indicator has two basic impacts on the City. The initial impact represents an opportunity cost for work that an employee does not perform. The second impact occurs at the termination or retirement of an employee when an expenditure is recorded for the payment of any unused vacation or sick leave. The second situation typically has the greatest implications for local governments. As employee leave accumulates, these payments are effectively postponed and the impact on future budgets increase.

The indicator has continued showing an overall increasing trend since 2005. The indicator did decline slightly in 2008 due to a number of retirements that occurred during the year. To control the growth of this indicator, the ICMA Handbook suggests that leave policies be established or amended to encourage employees to use their paid time off. Such policies include setting limits on accrued leave or cashing out accrued leave only if designated levels of paid leave have been used during the year. The City maintains a limit on the amount of accrued annual leave an employee may carry forward each calendar year. Sick leave accumulation is unlimited, but the amount that the City pays in the event an employee leaves employment is capped based on years of service. This type of leave policy is normal practice for Virginia local governments.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Accumulated Employee Leave	$2,967,643	$3,272,589	$3,582,480	$3,666,504	$3,983,594
Number of Employees (Full-time Equivalents)	555.6	571.9	595.2	613.9	638.7
Accumulated Leave per Employee (Full-time Equivalent)	$5,341	$5,722	$6,019	$5,972	$6,237

Accumulated Employee Leave



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Factor 6
Capital Plant Indicators

Much of a corporation's wealth is invested in fixed long-term assets, such as property, plant, and equipment; much of a city's asset base is reflected in capital assets such as streets, buildings, and heavy equipment. While the City does not use these assets to support profitable enterprise, the assets support the quality of life Harrisonburg residents have come to expect. These assets must be properly maintained or there may be undesired consequences. If, for example, the City does not maintain its streets, not only will taxpayers complain, but also the community will be less attractive to businesses that the City is encouraging to relocate.

Like many types of preventive maintenance, the cost of maintaining the asset is usually less than the costs of prematurely replacing the asset. Unfortunately, when revenues are tight and demands for services are high, the temptation to defer capital expenditures is great. A locality can get away with this for a year or so to temporarily ease its financial pressures. But if the City defers these expenditures for too long of a period, roads and sidewalks can become unsafe, property values can decline (leading to a decline in revenues), and the eventual cost of repairing or replacing the asset can become enormous. Developing the indicators described in this factor can help City officials determine if they are investing enough in its capital plant.

Indicator 26, Maintenance Effort, was not developed. It is extremely difficult to determine which amount for maintenance of assets were actually maintenance expenditures and which were administrative, beautification, or other expenses. Further, it is felt that this is not a problem area given the condition of the City's streets, parks, and other assets.

Indicator 27
Capital Outlay

A capital outlay refers to expenditures from general operating funds for operating equipment that is expected to last more than one year, for example a dump truck or a computer system. This indicator also includes expenditures for street repaving. It does not include expenditures for capital construction projects such as streets or bridges.

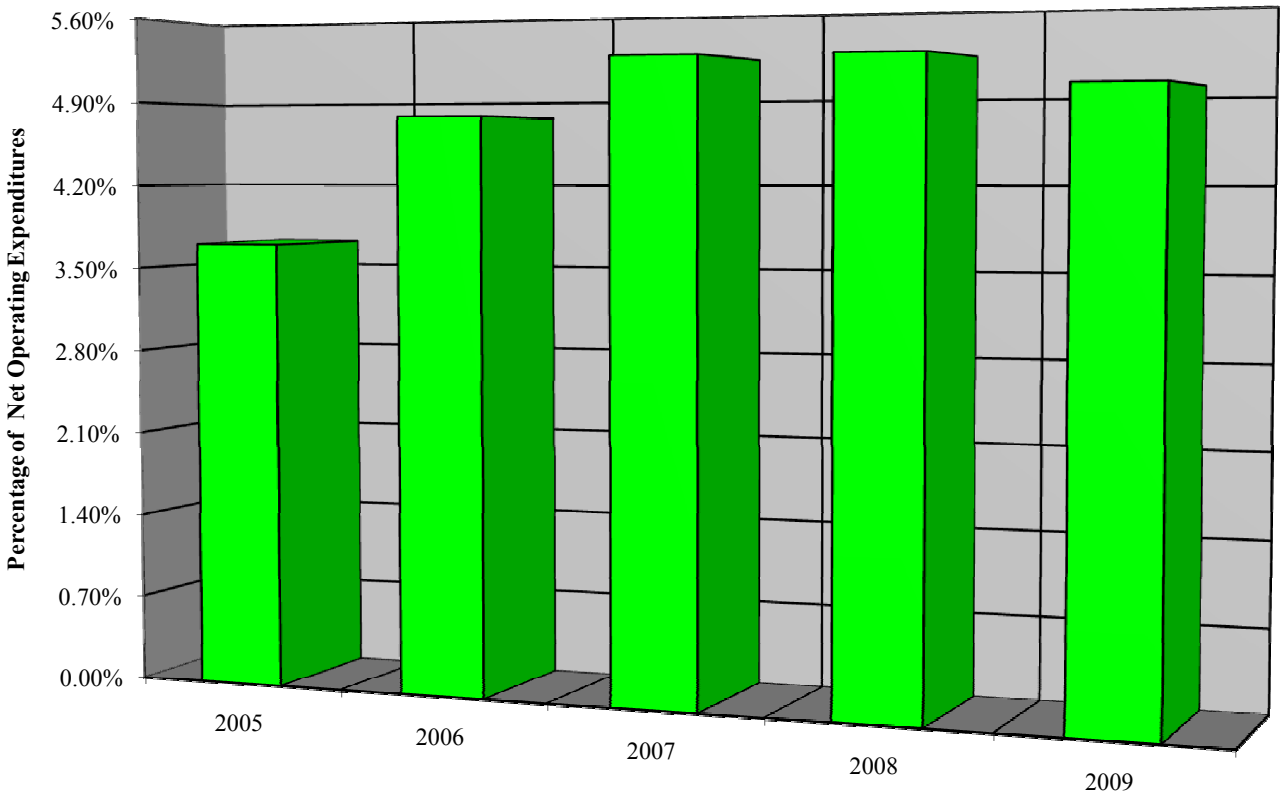
Capital outlay needs to be included in the budgeting process because equipment such as vehicles wear out and equipment like computer systems can become obsolete (or inefficient). Just as with maintenance efforts, during periods of low revenue, a city may postpone these expenditures for a year to focus on providing services, but there can be major costs associated with continual postponement. For instance, the decision not to purchase new vehicles may result in service trucks that spend more time in the shop than performing the operations for which they were originally purchased.

This indicator has been increasing since 2005 with a slight decline in 2009 due to a decrease in street paving expenditures

It is especially important to examine the overall trend in this indicator. If a city purchases a whole fleet of vehicles in one year, the next year's capital outlay is likely to be low. This is not a warning trend, but a three or more year decline in capital outlay as a percentage of net operating expenditures could be considered a warning trend.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Capital Outlay	$3,034,642	$4,232,683	$5,086,644	$5,519,756	$5,723,432
Net Operating Expenditures	$81,749,234	$88,791,720	$97,137,129	$105,259,548	$114,581,587
Capital Outlay as a Percentage of Net Operating Expenditures	3.71%	4.77%	5.24%	5.24%	5.00%

Capital Outlay



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Factor 7
Community Needs and Resources

The indicators developed under this category encompass a number of characteristics of the community. These indicators may or may not be important when considered alone, but they often help to explain the trends observed in other indicators. The indicators may also help determine whether or not to change some of the City's policies. For example, a decline in personal income may lead to a decrease in spending at restaurants and retail business, which will result in lower than expected tax revenues for the City. If unemployment rates have increased then the City could reexamine its tax rates and policies. Due to the difficulty in obtaining timely and accurate data, the following indicators were not developed:

Indicator 29, Population Density

Indicator 30, Population under 18 and over 64

Indicator 32, Poverty Households

Indicator 35, Home Ownership

Indicator 36, Vacancy Rates

Indicator 37, Crime Rates

Indicator 28
Population

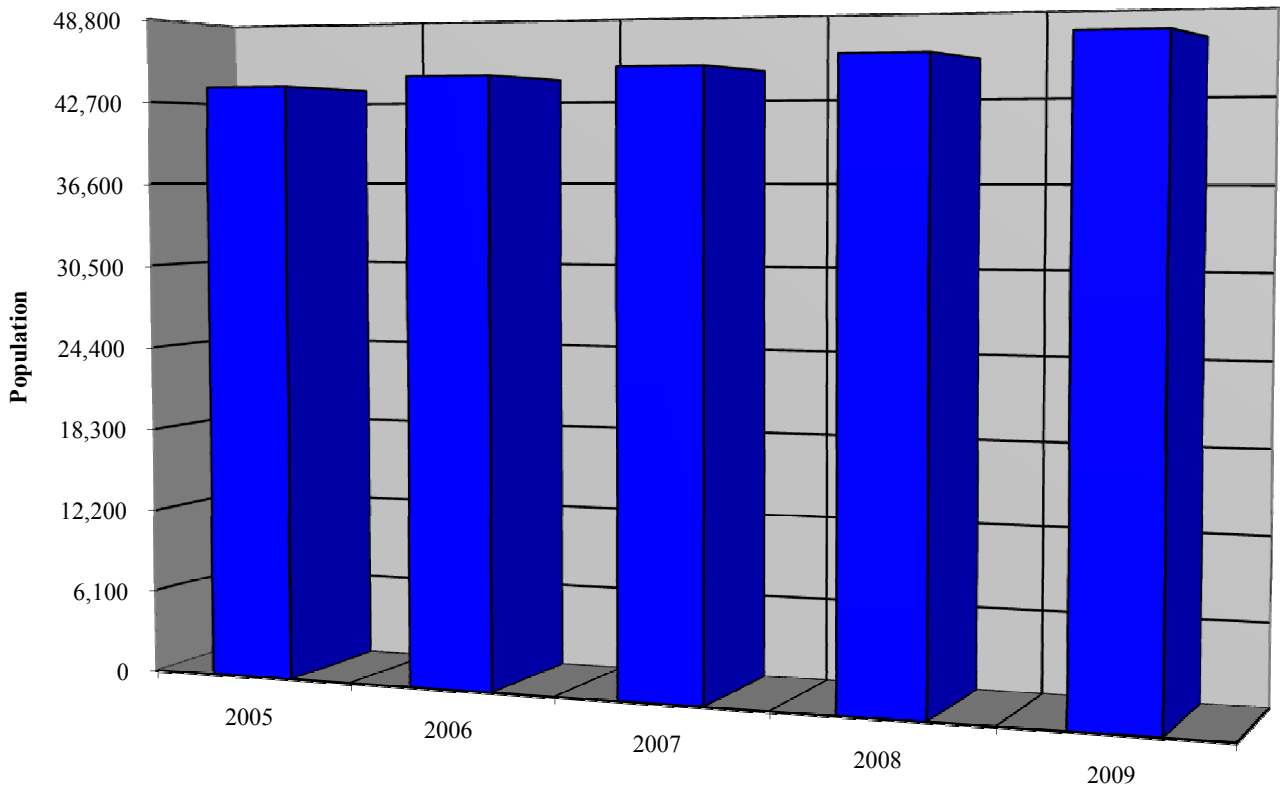
Harrisonburg has experienced population growth of roughly 7.3% over the past five years. This raises several interesting questions. Is this growth rate likely to continue? If it does, how long will the City's infrastructure support the growth? Will job growth keep pace? Is there sufficient undeveloped real estate to permit future development or will increased competition for housing, drive housing prices artificially high? How will JMU's continued expansion, particularly that of CISAT, affect the City's ability to sustain this growth? Looking at the change in the median age for the City reveals that the median age in 1990 was 23.7 compared to 22.6 in 2000. One obvious explanation is the continued growth of JMU during the past ten years.

Rapid changes in population size can have significant effects on a city's short-term and long-term financial health. For example, a rapid increase can cause the City to invest heavily in roads and schools or hire additional employees. If this trend is reversed, the City may be left with too large an asset base for its population. If the population is increasing due to young families with children, the City can expect its expenditures to increase rapidly for the foreseeable future. Conversely, if the expansion is due to an influx of professionals, it is likely that revenues will increase at a higher rate than expenditures.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Population	43,694	44,340	44,852	45,616	46,896

Source: Weldon Cooper Center for Public Service

Population


48,800
42,700
36,600
30,500
24,400
18,300
12,200
6,100
0
Population
2005
2006
2007
2008
2009

Indicator 31
Personal Income per Capita

Personal income per capita is important to a local government. When personal income is high, the City can generate higher tax revenues. Individuals with high personal income generally also require less in the way of services from the City. Further, the distribution of income is also important. A city with a large middle class and a small standard deviation of income will face different fiscal challenges than a city with a small number of very wealthy residents and a large number of low-income families, even though the two cities may have similar per capita income figures.

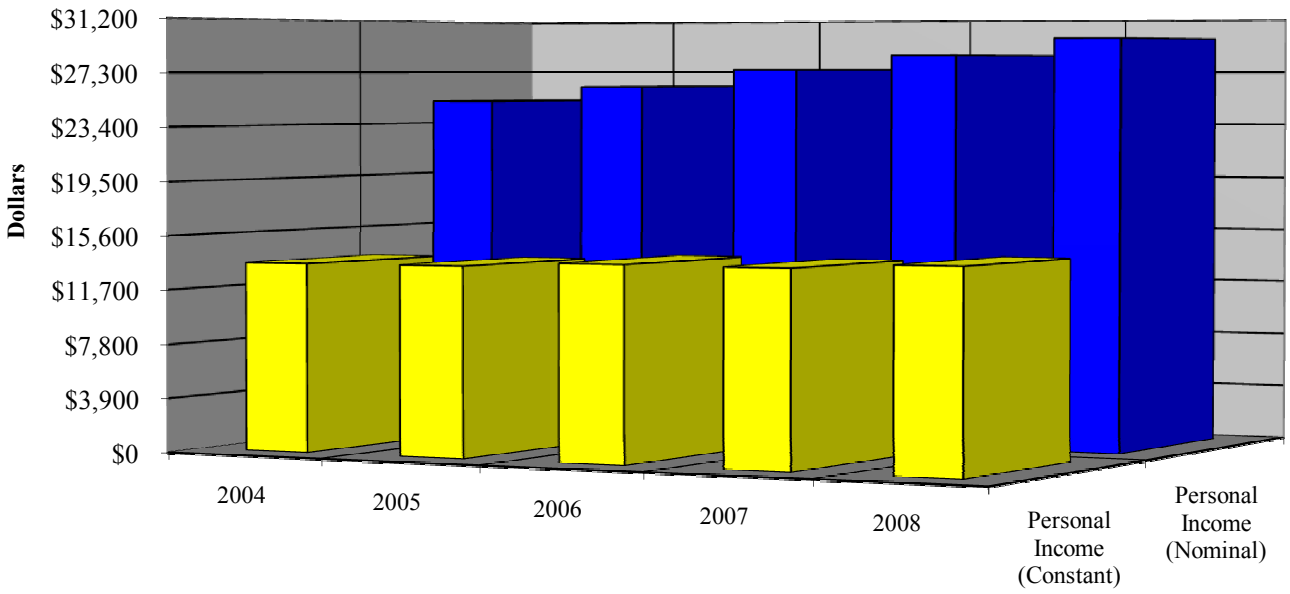
This indicator has shown a stable increase in nominal dollars for the five years studied with a five-year growth rate of 18.7% in nominal dollars. There are several possible explanations for this. First, improving economic conditions in the City could be increasing personal income. Second, since the population is also increasing, then the people moving in may have higher personal income than those moving out. Third, an increase in the cost-of-living due to inflationary pressures could be pushing personal income higher. This indicator has a five-year growth rate in constant dollars of 5.3%. This would indicate that most all of the nominal dollar growth was due to an increase in inflation.

In 2007, the most recent year that official data has been obtained, the Harrisonburg Metropolitan Statistical Area (HMSA) ranking climbed to 65th overall in the state, which was 68.5% of the $40,234 state average. The HMSA was 74% of the $38,615 national average.

Description	2004	2005	2006	2007	2008
Personal Income per Capita (Nominal) [a]	$25,094	$26,196	$27,555	$28,589[b]	$29,784[b]
CPI for the Area (1982-84=1.000)	1.846	1.922	1.971	2.050	2.080
Personal Income per Capita (Constant)	$13,594	$13,630	$13,980	$13,946	$14,319

Source: Bureau of Economic Analysis
[a] These amounts are for the Harrisonburg Metropolitan Statistical Area.
[b] Estimated.

Personal Income per Capita



Indicator 33
Property Value

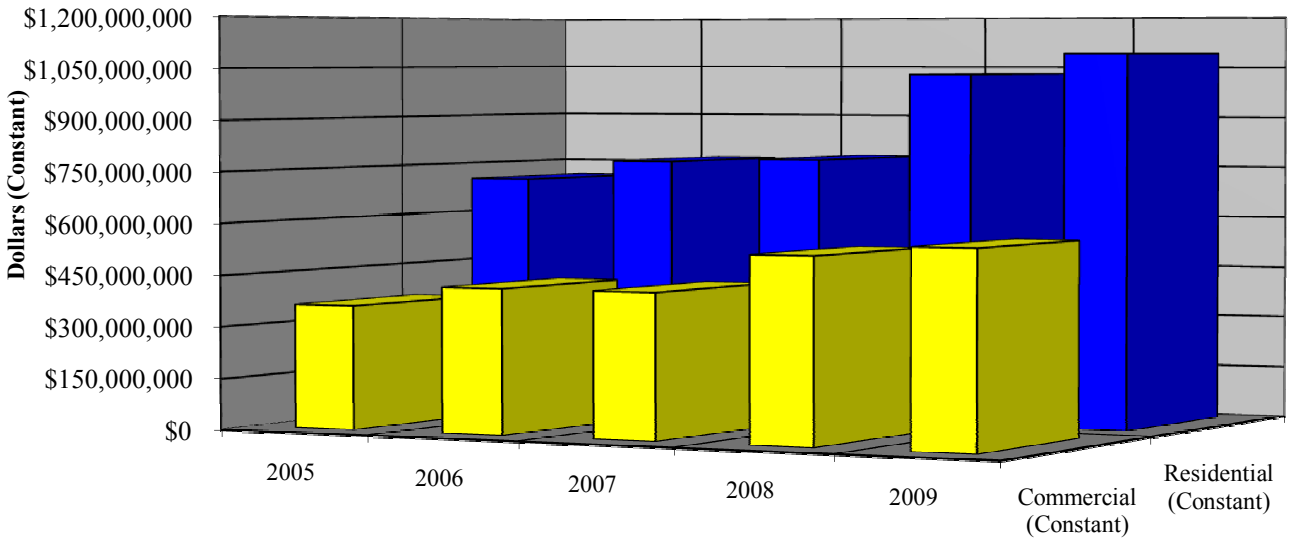
Property value is an important indicator since property taxes are such an important component of the City's revenues. The overall five-year growth rate for residential property is 74.2% in nominal dollars (54.6% in constant dollars) and 76.1% for commercial/industrial property (56.3% in constant dollars). It should be noted that 2006 and 2008 were reassessment years while 2009 was the first year of annual reassessments. Approximately one-half of the five-year increase occurred during the 2008 property value reassessment, which increased residential property values 38.1% (32.8% in constant dollars) and commercial/industrial property values 32.1% (27% in constant dollars).

If property values increase too fast, problems may result. If values rise faster than personal income or prices in general, more citizens, especially those on fixed incomes, may be unable to pay their taxes. The increase in value of commercial/industrial property (and resulting taxes) may cause companies to relocate to Rockingham County or even out of the area. Further, housing prices that are artificially high may deter people or companies from locating in the City.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Market Value of Taxable Residential Property (Nominal)	$1,306,273,698	$1,473,033,038	$1,528,652,129	$2,111,233,783	$2,275,254,580
Market Value of Taxable Commercial Property (Nominal)	$666,253,010	$808,066,456	$828,541,876	$1,094,534,067	$1,173,035,128
CPI for the Area (1982-84=1.000)	1.846	1.922	1.971	2.050	2.080
Market Value of Taxable Residential Property (Constant)	$707,623,888	$766,406,367	$775,571,856	$1,029,870,138	$1,093,872,394
Market Value of Taxable Commercial Property (Constant)	$360,917,124	$420,429,998	$420,366,249	$533,919,057	$563,959,196

Source: City of Harrisonburg Commissioner of the Revenue

Property Value



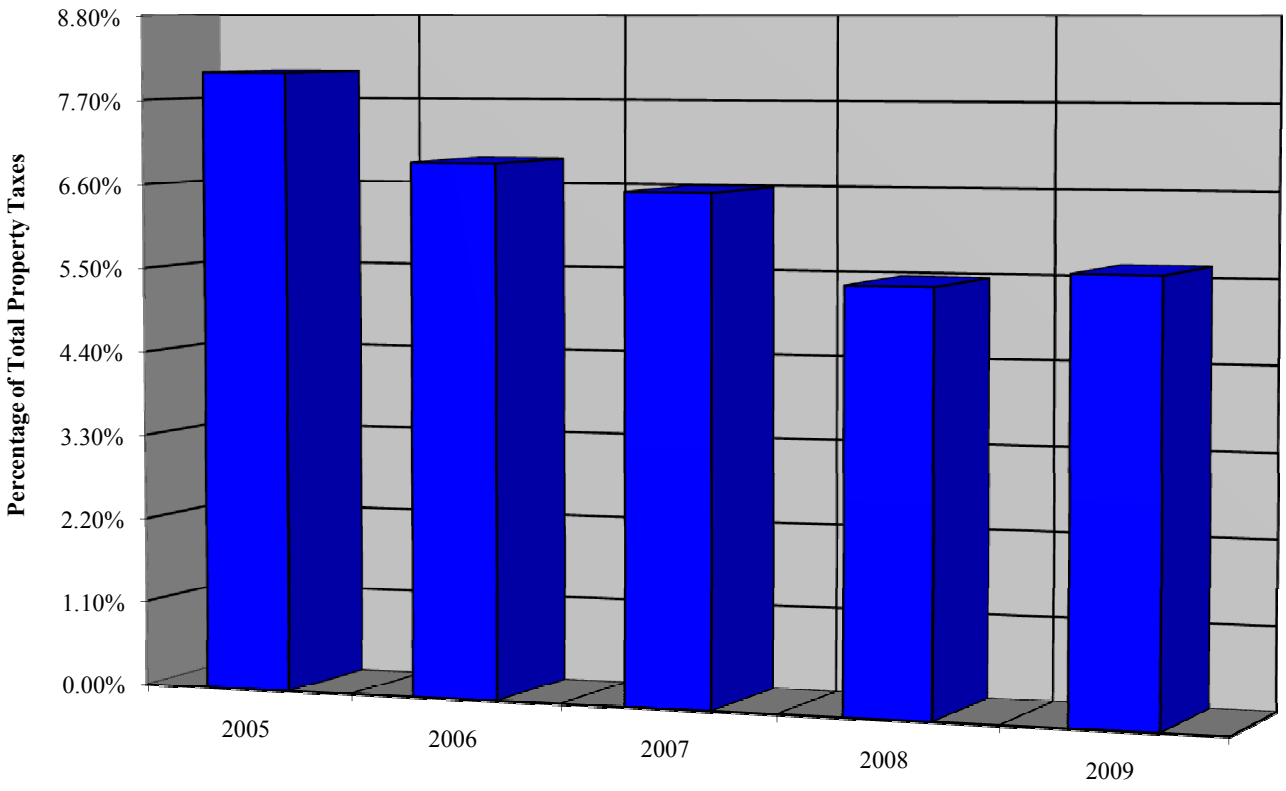
Indicator 34
Top Five Property Taxpayers

This indicator measures the concentration of the property tax base in the City. Since a diverse property tax base is essential to the health of any local government, this indicator can help analyze the vulnerability of the City to the fortunes of a few taxpayers. If a local government relies heavily on a few taxpayers for property taxes, it is vulnerable to any changes in these taxpayers' assessments. Bond rating agencies use this indicator to determine the degree of concentration within the locality. This concentration of revenue, in a few sources, raises the same concerns initiated by Indicator 3, Intergovernmental Revenues. Generally, a local government may have cause for concern if the top five taxpayers hold more than 20 percent of the property tax base.

This indicator has been decreasing overall the past five years but did increase slightly in 2009. Currently the top five taxpayers comprise 5.64% of the property tax base. This indicates that the City has been relying less on these large taxpayers since 2005.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Top Five Taxpayers	$1,579,355	$1,502,621	$1,560,999	$1,482,712	$1,640,991
Total Property Taxes	$19,603,537	$21,683,449	$23,722,324	$27,221,485	$29,095,900
Top Five Taxpayers as a Percentage of Total Property Taxes	8.06%	6.93%	6.58%	5.45%	5.64%

Top Five Property Taxpayers



Indicator 38
Unemployment Rate

A stable base of employment is vital to a city. In the short-term, a high level of unemployment may result in lower revenues, increased delinquency on taxes, and higher expenditures. A low level of unemployment may discourage new businesses from locating to the City due to labor shortages. The long-term implications are more serious. If unemployment rates bounce up and down, the City will have much greater difficulty accurately forecasting its revenues, expenditures, and capital needs, making long-range planning difficult. Additionally, it gives the impression of overall economic instability, making Harrisonburg less attractive to an individual or business thinking of relocating.

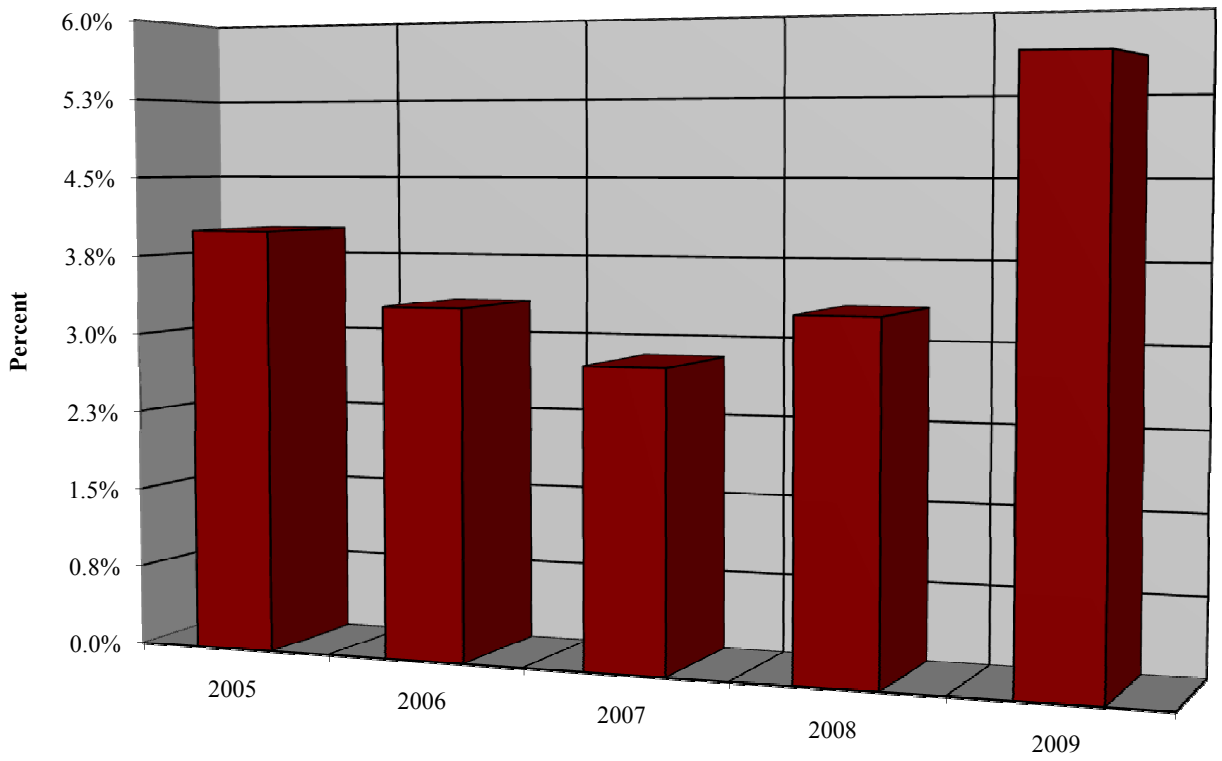
Bear in mind that the rate measures the number of residents who are unemployed; it does not consider whether those who are employed work in Harrisonburg or elsewhere in the region. Of course, there are limitations to the unemployment rate. People who are employed part-time or who are otherwise "underemployed" are still considered as employed for statistical purposes. People who have stopped looking for work are no longer considered unemployed, and are not counted as part of the work force. Consequently, the unemployment rate can be misleading.

The City's average annual unemployment rate had been decreasing from 2005 to 2007, but has been increasing since 2007 due to unfavorable economic conditions. As the following table shows, the City's unemployment rate is still equal to or lower than the state and national unemployment rates and continues to be one of the lowest in the state.

Description	2005	2006	2007	2008	2009
Local Unemployment Rate	4.0%	3.3%	2.8%	3.3%	5.6%
State Unemployment Rate	3.6%	3.2%	3.0%	3.3%	5.6%
National Unemployment Rate	5.3%	4.8%	4.5%	4.9%	7.6%

Source: Virginia Employment Commission.

Unemployment Rate



Indicator 39
Business Activity

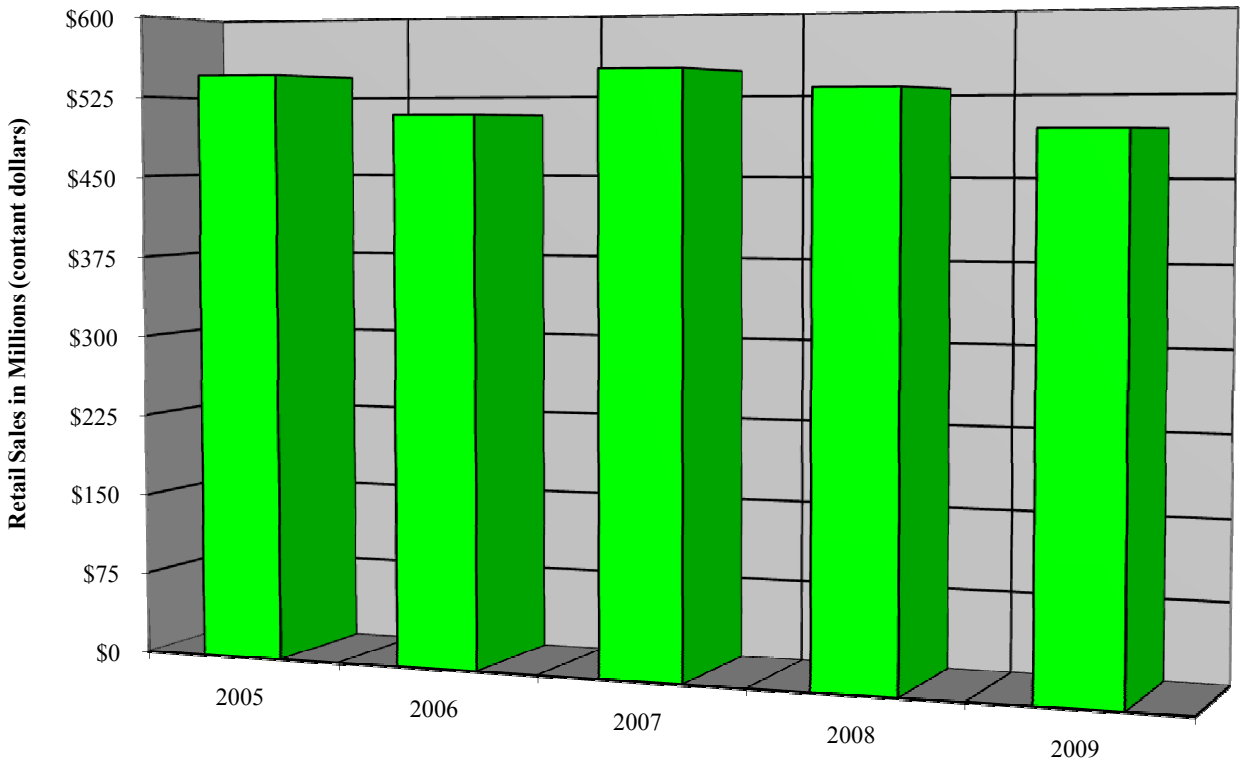
Growth in business activity is generally a sign of a healthy local economy. There are several measures of business activity. We have chosen to develop retail sales since local sales taxes and restaurant food taxes are important components of the City's revenues. The general economic environment has continued to erode since 2007 as evidenced by the retail sales data. Retail sales were essentially flat in 2008 while declining 5.5% in nominal dollars (6.7% constant dollars) in 2009. This indicator has declined overall in constant dollars since 2005.

According to the Virginia Department of Taxation, due to the implementation of a new accounting system, beginning with the July through September 2005 quarter, 2006 data does not directly compare with prior year data, which would explain the decline in retail sales figures for 2006.

Description	**2005**	**2006**	**2007**	**2008**	**2009**
Retail Sales (Nominal)	$1,005,488,786	$974,819,726	$1,080,727,995	$1,089,143,925	$1,029,004,052
CPI for the Area (1982-84=1.000)	1.846	1.922	1.971	2.050	2.080
Retail Sales (Constant)	$544,685,150	$507,190,284	$548,314,559	$531,289,720	$494,713,487

Source: Virginia Department of Taxation

Business Activity



Factor 8
External Economic Conditions

External economic conditions include trends in inflation, employment, economic wealth, and business activity. These conditions are generally beyond the control of local governments, which means that anticipation and preparation are the best means to adjust to changes in external economic conditions. In the long run, this requires building a local economic base that is protected from sudden downturns in the business cycle. To build such a base, the City must invest in the development and maintenance of capital plant and provide a level of service that will encourage businesses to stay and expand. It must also have a stable revenue producing commercial and industrial sector whose markets will not diminish during national recessions. Land-use controls and other governmental powers need to be applied carefully. Tax rates need to be competitive with jurisdictions providing similar services. An adequate labor force needs to be available. There needs to be an access to capital and an availability of good transportation routes. While no indicators have been developed for this factor, the following questions will help to evaluate how well the City can adapt to changes in external conditions:

1. What is the composition of the tax base? How sensitive is it to changes in the state and national economy?

   The City's tax base is diversified, in that there is no one person or industry that makes up a significant portion of the tax base. Table 7 on page 112 of the City's 2009 Comprehensive Annual Financial Report (CAFR) discloses that the ten largest taxpayers make up 8.7% of total property tax collections. However, it is fair to say that the Valley Mall and the Harrisonburg Crossing Shopping Center generate a significant portion of the City's sales tax. Consequently, the state and national economy does affect the City's revenue collection. Due to the diversification of the City's tax base, this effect is generally less severe than for other localities. This is a factor that City Staff monitors in an effort to soften any negative consequences. Indicator 34, Top Five Property Taxpayers provides further discussion on this issue.

2. What are some of the fixed costs that would be difficult to reduce?

   The City has many fixed costs associated with programs or activities that would be difficult or at least very unpopular to reduce or eliminate. Some of these are:

   Police protection
   Fire protection
   Emergency communications
   Highway maintenance
   Refuse collection
   Water and sewer service
   Education of children
   Welfare services
   Snow and ice removal
   Recreational activities
   Public and student transportation

3. In the past, have officials made the necessary budget decisions (raised taxes, cut expenditures) during adverse economic change?

   Reflecting on Indicator 15 may provide a partial answer to this question.

Factor 9
Intergovernmental Constraints

Local governments are creatures of the state. In a Dillon Rule state such as Virginia, not only is the City a creature of the state, but it can only do those things that are implied by expressly granted powers, and those powers essential to the operation of the municipal corporation. In addition to the Code of Virginia and the City Charter, there are many state regulations and federal laws and regulations that inhibit the flexibility of the City to act. These constraints can affect local government structure, service responsibilities, and financing powers. Of particular note are the unfunded state and federal mandates that have increasingly had a negative budgetary impact on local governments. Independent cities in Virginia are particularly vulnerable because they are required to provide education, health, mental health, and social services in addition to the provision of all of the more typical municipal functions. The "health, education and welfare" type of services has more than their share of mandates, many times without the accompanying funding. Also, the current moratorium on annexations for independent cities is a significant constraint. Again, no indicators have been developed, but questions to consider are as follows:

1. What is the level of revenues from state and federal sources? What is the level of expenditures that match the mandates associated with these revenues?

2. How close is the City to its debt ceiling?

   As disclosed by Table 11 on page 116 of the City's 2009 CAFR, the City can legally incur an additional $181.7 million in debt.

3. What will the ultimate impact be on the City in regard to reimbursements from the state for lost personal property tax revenues?

   Under legislation passed for fiscal year 2007, the state capped the total dollar amount that the City will receive for personal property tax reimbursements. The impact of this change has led to a shift in these reimbursements from being an elastic tax revenue to a pure intergovernmental revenue.

3. What will the ultimate impact be on the City in regard to budget cuts at the state level due to the current economic conditions and from Federal stimulus funding?

Factor 10
Natural Disasters and Emergencies

Natural disasters include fires, floods, blizzards, tornadoes, and similar events may require significant local government expenditures. To the extent that they can be anticipated, such events can be budgeted for, thereby lessening their impact on financial condition. When they require large unplanned expenditures, their impact can be substantial. Much of the burden may be absorbed by federal disaster assistance funds, but local government may still be heavily impacted.

Natural disasters and emergencies cause harm in several ways. First, they may destroy government equipment and property. Second, they may require the provision of emergency police, fire, and general welfare services. Third, the City may need to help the community replace or repair private property. Fourth, the natural disaster may undermine the health of the local business community, which may decrease the City's revenues. Predicting the occurrence of a natural disaster or emergency is not possible, but planning and preparation can lessen the impact if one occurs. Questions that can help in evaluating the impact of such an occurrence on the City's financial condition are as follows:

1. Does the City have sufficient reserves to respond to an emergency?

   Based upon the actions taken by Council when approving the budget for fiscal year 2010 and the Financial Management Policies, it appears the City has an adequate reserve to respond to most emergencies.

2. Does the City have an emergency operations plan?

   The City does have a written emergency operations plan. The City's Emergency Operations Plan was last revised and approved by City Council on October 27, 2009.

   In previous years, the City, in conjunction with the County, held an emergency operation drill in an effort to perfect its emergency operations plan. Since the terrorist attacks on September 11, city personnel have been reviewing and updating all emergency procedures in cooperation with other local, state and federal agencies and organizations. The City has also equipped Harrisonburg High School with generators for shelter in the event of a local emergency. In recent years, City officials have been participating in training courses offered by the Virginia Department of Fire Programs. These courses have covered topics concerning the U.S. Department of Homeland Security. This training is required for all localities receiving any type of federal funding.

3. Does the City have adequate insurance coverage?

The City currently has an employee whose job duties include risk management. The City does have sufficient insurance coverage. Further, the City reviews coverage on an ongoing basis to assure that the coverage remains sufficient.

Factor 11
Political Culture

Political culture refers to a community's attitudes toward taxes and services. Of all the factors that effect financial condition, local political culture is perhaps the most difficult to analyze, primarily because it is influenced by the interaction of individuals and by their varying economic, ethnic, religious, and social backgrounds. Analysis of political culture is highly subjective and there are no easily defined or analyzed indicators. Some issues to be considered in addition to social and demographic characteristics include the following:

- The manner of political representation
- The extent of citizen participation
- The structure of the government organization
- The decision-making process
- The content of political issues
- The age, size, and density of the community

Staff has not attempted to respond to these issues in this document.

Factor 12
Management Practices and Legislative Policies

In many respects, management practices and legislative policies are the most critical influences on a local government's financial condition. The response to environmental influences can have a crucial effect as highlighted in the chart showing the 12 factors. A local government's response to changes in environmental factors (left side) is filtered through the organizational factors to result in the financial factors (right side).

Local governments can theoretically adjust to environmental changes by changing its expenditure pattern. This assumes that there will be enough notice of the problems, that the City understands their nature and extent, that it knows what to do, and that it is willing to do it. While these are optimistic assumptions, practices and policies are the factors over which a local government has control. It is through practices and policies that a government can exert leverage when dealing with financial problems.

When credit rating firms evaluate the financial condition of local government, they consider management practices and legislative policies to be very important. They assess the professionalism of management by examining the quality of financial reporting and capital planning, and by checking to see whether the government has used any financial gimmickry. They also determine the responsiveness of the governing body to raise taxes when needed. Sound financial practices and policies enable a local government to maintain good financial condition and avoid financial emergencies.

Management Practices

The City has made major improvements in its financial reporting. In fact the City has received the Certificate of Achievement for Excellence in Financial Reporting the last fourteen years for its Comprehensive Annual Financial Report (CAFR). The City has significantly improved its Capital Improvement Program (CIP) preparation, and has also adopted Financial Management Policies. A list of indicators has not been developed by ICMA because of the number and variety of management

practices. However, there are practices that if relied on, can damage the local government's financial condition. These practices fall into three categories:

1. **Repeated use of one-time revenue sources, such as prior years' reserves (fund balance) or proceeds from the sale of assets, to balance the budget.** An operating deficit occurs when current expenditures exceed current revenues. This may occur even though the annual budget is balanced from a previous year's surplus. An operating deficit for one year may not be a cause for concern, but frequent and increasing deficits can be a warning sign. If allowed to continue, a question that needs to be asked is "Is the government continuing a level of services and expenditures that it may not be able to afford in the long run?" Telltale signs pointing to the existence of an operating deficit include using fund balances from prior years and one-time accounting changes. The use of fund balances to sustain an operating deficit can be damaging in two ways. First, the City is left with fewer financial resources to cope with an emergency; and second, relying on these reserves may affect the government's credit rating, because credit rating firms examine the history of fund balances. Council has adopted a Financial Management Policies manual that sets guidelines for the use and size of the General Fund's undesignated fund balance. These guidelines include several commitments: (1) maintain a fund balance of no less than 10% of the General Fund budget plus adequate funds for working capital purposes, (2) ensure adequate funds for liquidity, and (3) use of the fund balance should be for "pay as you go" capital project expenditures.

2. **Deferring large amounts of current costs to the future: deciding for example to postpone maintenance of capital assets.** Deferring current costs has several general drawbacks. First, it sustains a level of services and expenditures that the government may not be able to afford in the long run; and second, it can affect bond ratings. These costs do not normally show up in financial records so that their effect may not be recognized until the problem is serious. Delaying these costs when resources are scarce is a short-term solution and many times result in larger expenditures at later dates. Previous Councils have committed the City to maintain existing infrastructure through implementation of policies delineated in the Financial Management Policies.

3. **Ignoring long-range or full-life costs of a liability.** Failing to consider long-range costs of a liability can jeopardize financial condition by building a future imbalance between revenues and expenditures. Not costing out non-salary benefits, or constructing or purchasing a capital asset without calculating the full-life costs can create long-term financial difficulties. The City should use life cycle costing more when purchasing major pieces of equipment. The Capital Improvement Program (CIP) attempts to anticipate additional operating costs for all expenditures if they are projected to increase over current levels. Finally, the CIP financial information reflects anticipated costs for personal services, including fringe benefits, for the next five years.

Legislative Policies

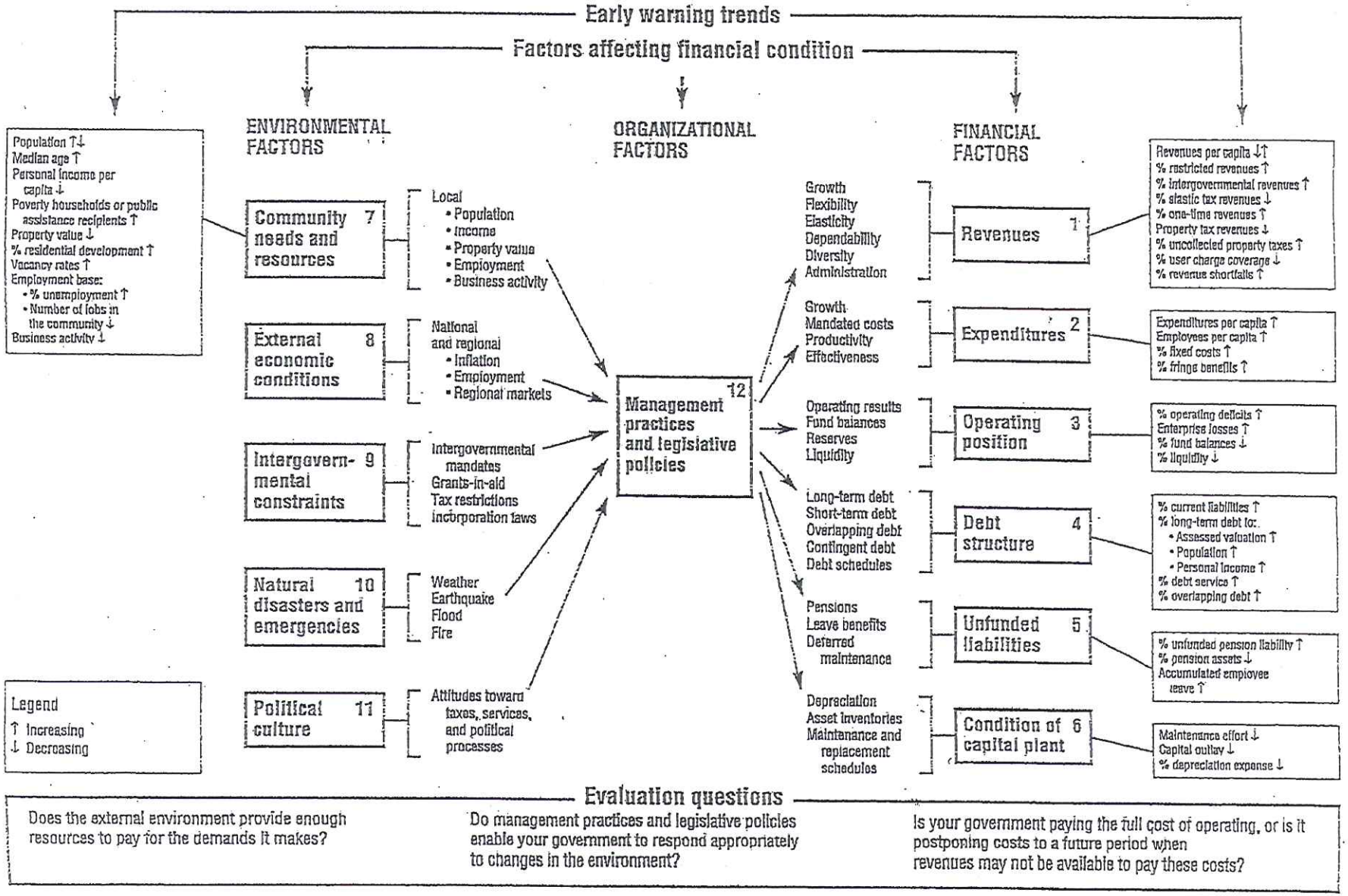
The evaluation of legislative policies has been separated for this analysis. However, it should be obvious that legislative policies have significant impact on management practices. This portion of Factor 12 is designed to assist in the evaluation of the usefulness of the City's legislative policies in protecting and improving its financial condition. Financial policies will be defined here as goals for the financial

operation of the City. Setting goals is important for financial health because it gives officials a long-range perspective on the current approach to financial management. It also helps to reach a consensus on the kind of financial condition desired for the City.

When financial policies are dispersed among a variety of documents, are unwritten, or are developed on a case-by-case basis, decisions are often made without consideration of other current policy decisions, past policy decisions, or future policy alternatives. This kind of policy making can lead to the development of conflicting policies, inconsistent policies, or incomplete policies. A formal set of policies can help the City Manager and Council identify conflicts, inconsistencies, and gaps in existing practices. Other benefits include:

1. Policy statements contribute to credibility and confidence in the government.
2. Credit rating firms and investors perceive the statements as a commitment to sound financial management and fiscal integrity.
3. Policies save time by not discussing the same issues for each related decision.
4. The development process requires focus on the total financial condition rather than single issues.
5. Discussion and adoption of formal policies can help to prepare for financial emergencies and avoid reliance on short-term solutions.
6. Setting policies can improve fiscal stability by helping officials to look down the road, plan tax rates and expenditures two to three years ahead, and be consistent in approaches to planning.
7. Policies contribute to continuity in the government's financial affairs since local government officials may change over time.

Staff continues to evaluate the City's current policies and procedures to determine any needed changes and additions to such documents as the Capital Improvement Program (CIP) and the Financial Management Policies.


Early warning trends
Factors affecting financial condition
Population ↑↓
Median age ↑
Personal income per capita ↓
Poverty households or public assistance recipients ↑
Property value ↓
% residential development ↑
Vacancy rates ↑
Employment base:
• % unemployment ↑
• Number of jobs in the community ↓
Business activity ↓
ENVIRONMENTAL FACTORS
Community needs and resources 7
Local
• Population
• Income
• Property value
• Employment
• Business activity
External economic conditions 8
National and regional
• Inflation
• Employment
• Regional markets
Intergovern-mental constraints 9
Intergovernmental mandates
Grants-in-aid
Tax restrictions
Incorporation laws
Natural disasters and emergencies 10
Weather
Earthquake
Flood
Fire
Political culture 11
Attitudes toward taxes, services, and political processes
ORGANIZATIONAL FACTORS
Management practices and legislative policies 12
FINANCIAL FACTORS
Growth
Flexibility
Elasticity
Dependability
Diversity
Administration
Revenues 1
Revenues per capita ↓↑
% restricted revenues ↑
% intergovernmental revenues ↑
% elastic tax revenues ↓
% one-time revenues ↑
Property tax revenues ↓
% uncollected property taxes ↑
% user charge coverage ↓
% revenue shortfalls ↑
Growth
Mandated costs
Productivity
Effectiveness
Expenditures 2
Expenditures per capita ↑
Employees per capita ↑
% fixed costs ↑
% fringe benefits ↑
Operating results
Fund balances
Reserves
Liquidity
Operating position 3
% operating deficits ↑
Enterprise losses ↑
% fund balances ↓
% liquidity ↓
Long-term debt
Short-term debt
Overlapping debt
Contingent debt
Debt schedules
Debt structure 4
% current liabilities ↑
% long-term debt to:
• Assessed valuation ↑
• Population ↑
• Personal income ↑
% debt service ↑
% overlapping debt ↑
Pensions
Leave benefits
Deferred maintenance
Unfunded liabilities 5
% unfunded pension liability ↑
% pension assets ↓
Accumulated employee leave ↑
Depreciation
Asset inventories
Maintenance and replacement schedules
Condition of capital plant 6
Maintenance effort ↓
Capital outlay ↓
% depreciation expense ↓
Legend
↑ Increasing
↓ Decreasing
Evaluation questions
Does the external environment provide enough resources to pay for the demands it makes?
Do management practices and legislative policies enable your government to respond appropriately to changes in the environment?
Is your government paying the full cost of operating, or is it postponing costs to a future period when revenues may not be available to pay these costs?

Conclusion

Overall the City appears to be in sound financial condition when looking collectively at the trends for all of the developed indicators. Of the 26 indicators that were developed for which there are defined warning trends, ten qualified as constituting a warning trend. In addition, six of the indicators have benchmarks that have been developed by the credit rating agencies. The City has exceeded one of the credit industry benchmarks. The following list summarizes any significant trends that match the ICMA definition of a warning trend.

ICMA Warning Trends

1. **Indicator 2 – Restricted Revenues –** The warning trend is increasing restricted revenues as a percentage of net operating revenues. Although there was slight decrease in 2008, this indicator has been increasing overall since 2005 due mainly to increases in state funding for education.

2. **Indicator 3 – Intergovernmental Revenues –** The warning trend is increasing intergovernmental revenues as a percentage of net operating revenues. Although there was slight decrease in 2008, this indicator has been increasing overall since 2005. Increased state and federal funding for education have contributed to this increase, as well as, increased state street and highway maintenance funding.

3. **Indicator 10 – Net Operating Expenditures per Capita –** The warning trend is increasing net operating expenditures (constant dollars). This indicator has shown a trend of increasing expenditures per capita the last five years.

4. **Indicator 12 – Employees per Capita –** The warning trend is an increasing number of employees per capita. This indicator has been gradually increasing over the past five years.

5. **Indicator 14 – Fringe Benefits –** The warning trend is increasing fringe benefit expenditures as a percentage of salaries and wages. This trend has been increasing the past five years due to an increase in VRS retirement rates, but did decline in 2009.

6. **Indicator 15 – Operating Surplus (Deficit) –** The warning trend is increasing operating deficits or surpluses as a percentage of net operating revenues. This trend has shown an increase in operating deficits over the past five years with a significant increase in 2009 due to a decline in operating revenues from the current weak economic conditions.

7. **Indicator 20 – Long-term Debt –** The warning trend is increasing long-term debt per capita. This indicator has been increasing since 2005 mainly due to the $50 million bond issue in 2007 for construction of the new elementary/middle school complex and the related construction of Linda Lane.

8. **Indicator 21 – Debt Service –** The warning trend is increasing debt service as a percentage of net operating revenues. This indicator has shown an increase since 2007 mainly due the $50 million bond issue mentioned in the warning trend for Indicator 20.

9. **Indicator 25 – Accumulated Employee Leave –** The warning trend is increasing accumulated leave per full-time equivalent employee. This indicator has been increasing the past five years although it did decrease slightly in 2008 due to employee retirements.

10. **Indicator 39 – Business Activity –** The warning trend is decreasing retail sales in constant dollars. This indicator has shown declining retail sales in constant dollars since 2007 of 9.6% mainly from current economic conditions.

Credit Industry Benchmarks

1. **Indicator 15 – Operating Surplus (Deficit) –** This indicator violates all four credit industry benchmarks established for this indicator. The four benchmarks are: (1) two consecutive years of operating deficits, (2) the current year operating deficit greater than that of the previous year, (3) two or more operating deficits in the last five years and (4) an abnormally large deficit of more than 5 to 10 percent in one year.

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